S. Hrg. 101-37

CRITICAL ISSUES AND PROBLEMS FACING THE NEW ADMINISTRATION AND CONGRESS

HEARING

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

JANUARY 18, 1989

Printed for the use of the Committee on Governmental Affairs

U.S. GOVERNMENT PRINTING OFFICE
96-696 WASHINGTON : 1989

S401-34

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

COMMITTEE ON GOVERNMENTAL AFFAIRS

JOHN GLENN, Ohio, *Chairman*

SAM NUNN, Georgia
CARL LEVIN, Michigan
JIM SASSER, Tennessee
DAVID PRYOR, Arkansas
JEFF BINGAMAN, New Mexico
HERBERT KOHL, Wisconsin
JOSEPH I. LIEBERMAN, Connecticut

WILLIAM V. ROTH, Jr., Delaware
TED STEVENS, Alaska
WILLIAM S. COHEN, Maine
WARREN B. RUDMAN, New Hampshire
JOHN HEINZ, Pennsylvania
PETE WILSON, California

Leonard Weiss, *Staff Director*
Harry G. Broadman, *Chief Economist*
Robert Coakley, *Professional Staff Member*
Jo Anne Barnhart, *Minority Staff Director*
Michal Sue Prosser, *Chief Clerk*

CONTENTS

Opening statements: Page
Senator Glenn 1
Senator Sasser 22

WITNESSES

WEDNESDAY, JANUARY 18, 1989

Charles A. Bowsher, Comptroller General, U.S. General Accounting Office, accompanied by Frank Conahan, Assistant Comptroller General for National Security and International Affairs; J. Dexter Peach, Assistant Comptroller General for Resources, Community and Economic Development Programs; and Richard Fogel, Assistant Comptroller General for General Government Programs 5

APPENDIX

Prepared statement of Charles A. Bowsher, Comptroller General, U.S. General Accounting Office 47
Supplement to prepared statement of Charles A. Bowsher 77
Charts submitted by the U.S. General Accounting Office 97
U.S. General Accounting Office [GAO] Transition Series, November 1988:
The Budget Deficit 101
The Public Service 120
Revenue Options 135
Financial Services Industry Issues 163
International Trade Issues 186
Information Technology Issues 210
Financial Management Issues 236
Program Evaluation Issues 271
Defense Issues 299
Health and Human Services Issues 319
Commerce Issues 358
Agriculture Issues 380
Justice Issues 417
Veterans Affairs Issues 438
NASA Issues 462
Energy Issues 477
Education Issues 538
Department of State Issues 560
Environmental Protection Agency Issues 583
Department of Labor Issues 612
Housing and Urban Development Issues 641
Foreign Economic Assistance Issues 656
Interior Issues 671
Transportation Issues 694
Internal Revenue Service Issues 727
Treasury Issues 516

CRITICAL ISSUES AND PROBLEMS FACING THE NEW ADMINISTRATION AND CONGRESS

WEDNESDAY, JANUARY 18, 1989

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 9:40 p.m., in room SD-342, Dirksen Senate Office Building, Hon. John Glenn (Chairman of the Committee) presiding.

Present: Senators Glenn, Levin, Pryor, Lieberman, and Kohl.

OPENING STATEMENT OF CHAIRMAN GLENN

Chairman GLENN. The hearing will be in order.

Before we start the business of the morning, I would like to welcome two new members to the Committee. Senator Joe Lieberman received his bachelor's degree from Yale, his law degree from Yale; was elected to the Connecticut State Senate, served there for 10 years, the last 6 as Majority Leader, and served as Connecticut's 21st Attorney General and was re-elected to that post in 1986. He was elected to the Senate this past fall and hit the ground running. On January 14th, he delivered the Democratic response to President Reagan's final weekly radio broadcast and used the occasion to discuss protection of the world's environment. Joe is the author of four books, including a book on nuclear nonproliferation. We welcome him to this Committee, particularly with that area of expertise.

With Dexter Peach here, Joe, you and Dexter can work together a lot on that topic. He has testified a lot on that subject before us here, and this Committee has been particularly active through the years in the area of nuclear nonproliferation, as well as on the nuclear cleanup that has been in the news so much recently.

Joe, we have had excellent help from GAO in all of our efforts on this. How many reports do you have out on this issue Dexter? It is about 31 reports?

Mr. PEACH. Well, if you go back to 1980, maybe in the area of 50 reports.

Chairman GLENN. About 50 of them. Okay. I am behind the times, then. I think about a third of them have been done at my request, something like that.

Mr. BOWSHER. Yes.

Chairman GLENN. So we have been very active in that area and have had excellent help from GAO. In any event, we welcome you to the Committee, Joe.

Our other new Democratic member is Senator Herb Kohl. Herb is a civic leader, sportsman, businessman. He was elected as Wisconsin's 25th U.S. Senator on November 8th. He earned a bachelor of arts degree at the University of Wisconsin, Madison, and an M.B.A. from Harvard's Graduate School of Business. From 1970 to 1979, he was president of the Kohl Corporation, a large chain of grocery and department stores. So he brings a broad business background to the Senate.

He also has been very active in civic affairs; in Milwaukee's United Way Campaign from 1975 to 1977; he has served as State Chairman of the Democratic Party; and in 1968 negotiated with the National Basketball Association and got a franchise for Milwaukee. We are happy to have him here with all of that background to bring to bear on things that this Committee deals with.

We have one other new member who is not here yet this morning—perhaps he will be here a little later—on the Republican side, and that is Senator Pete Wilson, who has been here for some time in the Senate, but not on this particular Committee. We welcome him also. I have worked with Pete. We are serving together on the Armed Services Committee, and I have done a lot of work with Pete in the manpower area over there, where he was formerly Chairman of the Manpower Subcommittee that I now chair. We are glad to have him on the Committee also.

I was wondering whether either one of you gentlemen want to say anything this morning as an opening. Any comments you might have would be welcome.

Senator LIEBERMAN. Thank you, Senator Glenn, Mr. Chairman. Thank you for the welcome.

Let me just say simply that I am thrilled to be here in the Senate with this extraordinary honor and opportunity to serve my State and my Nation. And I am particularly pleased that I have the opportunity to serve on this Committee under your leadership.

It seems to me that this Committee has a critical mission at this particular time, which is, if I may oversimplify it, to make sure that this Government of ours functions as efficiently as possible. And I am very anxious to be of help to you and be involved in this Committee in a very positive and productive way, and I thank you for your welcome.

Chairman GLENN. Thank you very much.

Herb, do you have any comments this morning?

Senator KOHL. Well, I, too, of course, am very pleased to be here. I am most honored to be here as a member of the United States Senate, and particularly happy to be a member of John Glenn's committee because I have tremendous regard for John and everything that he has meant in our country over the years.

I would like to hope that I can bring some of my background as a businessman to bear on some of the problems that come before this Committee, and I would like to hope that I can be effective and make some contribution. I know I will work awful hard to do that, and I do appreciate the fact that you welcomed me to your Committee.

Chairman GLENN. Thank you. Thank you much.

Just one word, too, that follows along this line about the broad background that we have with our new members. That is, this

Committee has the broadest background, the broadest areas of responsibility, of any Committee on Capitol Hill. We combine here what three different Committees do in the House, and we also have the broadest mandate of things to do, because we oversee the efficiencies of Government, number 1, and the organizational aspects of Government, number 2.

Now, there are a lot of issues covered under that. It is almost like having a hunting license to look into whatever you want to look into in Government. Ours is a Committee with a very, very broad jurisdiction. It is not like the Judiciary Committee, which is almost all lawyers concentrated in one area; nor like the Agriculture Committee which is also channeled in one area. Because of our broad jurisdiction, we work very, very closely with GAO, the General Accounting Office, because they are the ones who can look into all of these things for us.

I do not know, Mr. Bowsher, whether that you get more requests for investigations into different areas from any other Committee of the same number that you do from here. Perhaps you do.

Mr. **Bowsher**. Only John Dingell. [Laughter.]

Chairman **Glenn**. Well, anyway we have a broad mandate, and GAO helps us carry that out. We welcome the GAO back here for our very first hearing of this 101st Congress.

Comptroller General Charles Bowsher will testify before us today. Under his leadership, the General Accounting Office has put together a very impressive series of transition studies for the new administration and Congress. A whole series; I think there are 26 of them that apply to different agencies and departments of Government. I do not know how many are available to the press and available to other people here, but it is a good series of studies.

Comptroller Bowsher will summarize the reports by highlighting the most critical issues our Government currently faces.

The Congress looks to the GAO to give us doses of reality. And we are going to get a heavy dose of reality this morning.

Tomorrow, the Committee will hold a confirmation hearing for President-elect Bush's nominee for Director of the Office of Management and Budget, Richard Darman.

Now, I would note that I happen to think that position is the number 2 power position in Government. It is second only to the presidency. The head of OMB does more to make things function in Government or not function, as he sets priorities in trying to carry out the President's mandate. Comptroller Bowsher's presentation today will provide important themes for that hearing tomorrow.

I predict when the 101st Congress comes to an end 2 years from now, we will look back on the lessons learned from the Comptroller's testimony today. And perhaps having looked at this as school, we will look at this hearing today as "Congress 101." At the start of this class, let me state our objective in this Committee is to face up to the challenges we hear this morning, and hope we come out with a grade of "A".

Before we turn to the testimony, I will reflect just a moment on a historical point which serves to explain the importance of this hearing.

This Committee, the GAO, and the old Bureau of the Budget, now OMB, have very similar roots. All three institutions were created in the same year—1921. And while each has evolved its own role as actors in our constitutional form of Government, they have remained inextricably linked throughout time.

The Senate established this Committee after World War I in response to the debate over whether there was a need for a "National Budget" process to control the growing fragmentation of spending programs. Before that, the President was not required to submit a budget to the Congress. He could do it or not do it, as he saw fit, or as the Congress requested.

The very first bill passed by this Committee was the National Budget and Accounting Act of 1921, and it created the Bureau of the Budget and the General Accounting Office. The Bureau of the Budget now is called OMB; it was changed in 1972 and some of its mission was changed. That "M" for management was added to its function. The OMB became the President's chief arm for assembling the budget. At the same time, the GAO became a vital oversight arm of the Congress.

The work of this Committee in overseeing Government operations has been linked often to the work of the GAO and OMB. This triad is frequently at the center of the relationship between the Executive and Legislative branches of Government. That is one reason I felt it was important to hear from the Comptroller General on the results of the GAO's analyses just before we meet President-elect Bush's selection to head OMB.

With a new administration and Congress, we are at a fresh moment in history. The challenges ahead of us are great, they are difficult, they are monumental, as we all know. I am one who strongly believes that there must be trust and goodwill between the Executive and Legislative branches of Government if we are to successfully meet those challenges. Distrust and adversarial relations lead to stalemate. The country cannot afford inaction. Integrity, honesty, and candor are absolutely vital to a successful relationship. My fervent hope is that we have a good working relationship with the new administration.

So our hearing today begins that fresh start. Comptroller Bowsher, it is a pleasure to have you and your associates with us this morning here. We look forward to your testimony, and perhaps for the record here, you will introduce all the associates you brought along with you.

Mr. **Bowsher**. Thank you very much, Mr. Chairman.

It is my pleasure to introduce Frank Conahan on my left, who is the head of all our international and defense work; Dick Fogel on my immediate right, who heads up our general Government work; and Dexter Peach on my extreme right, who heads up all our energy, natural resources work and, as you point out, has done a lot of work in the nuclear area.

Chairman **Glenn**. Before we proceed, I overlooked one thing, and that is I did not call on Senator Levin for any opening remarks he might want to make this morning. I am sorry, Carl. I apologize.

Senator **Levin**. Thank you, Mr. Chairman.

Other than joining you in a warm welcome to our two new colleagues, I have no opening statement. They obviously know already just how lucky they are to be working with you, Mr. Chairman.

With your special open, honest, and inquiring way of going about things, this is a great Committee to be working on.

I want to join you in welcoming them to our midst. We look forward to a long and rewarding relationship.

Chairman **Glenn**. Thank you very much.

TESTIMONY OF CHARLES A. BOWSHER, COMPTROLLER GENERAL, U.S. GENERAL ACCOUNTING OFFICE;[1] ACCOMPANIED BY FRANK CONAHAN, ASSISTANT COMPTROLLER GENERAL FOR NATIONAL SECURITY AND INTERNATIONAL AFFAIRS; J. DEXTER PEACH, ASSISTANT COMPTROLLER GENERAL FOR RESOURCES, COMMUNITY AND ECONOMIC DEVELOPMENT PROGRAMS; AND RICHARD FOGEL, ASSISTANT COMPTROLLER GENERAL FOR GENERAL GOVERNMENT PROGRAMS

Mr. **Bowsher**. Mr. Chairman, I have a short, 5½ page statement which I would just like to read.

I will start off by saying we are pleased to be before the Committee today to offer our views on the critical issues the Congress and the new administration must deal with if Government is to function well. Our message, unfortunately, is not too optimistic. I wish I could tell you that the problems we face in our Government operations are small and easily solved. The truth is that our problems are major; they are growing; and they will not be easily or quickly dealt with.

The essence of Federal management is policy implementation and delivery of program services, and a failure to invest sufficiently in key operations of Government leads to a number of unpleasant consequences.

First, it undercuts our ability to offer the American people the one thing that they have every right to expect, and that is a Government that works well in providing services.

Second, because Government operations affect our dealings with other nations, in the area of trade, diplomacy, law enforcement, defense and others, such a failure has international ramifications.

And, third, because Government operations are linked with the smooth functioning of the private sector, the Nation's business community is inevitably affected when we fail to invest in the central operations of our Government.

Unfortunately, GAO's work over the past decade has shown too often that we have not invested wisely in key governmental operations. We have summarized many of the areas we believe have to be addressed in our 26 transition series reports.

I recommend these reports to the new Senators. They provide you an idea of what the major problems are in the Government. We did an individual report for each department, and a few on cross-cutting issues.

These reports were based on work that we have done over the past decade, examining major issues and problems in the executive agency departments. Our purpose in doing the transition series was to summarize the major issues in a readable fashion. We wanted to facilitate the ability of the Congress and the new administration to focus on key issues needed to improve the functioning of Government. Attachment 1 to my statement lists the 26 reports.[2]

---

[1] See p. 47 for Mr. Bowsher's prepared statement.

The number 1 issue is the Federal deficit, and unless the deficit is solved, including finding ways to finance the growing list of unavoidable, but so far unfunded, costs, it will hamstring our ability to achieve other vital policy goals. There are no quick or painless solutions to the budget problem, and the budget problem is substantially worse than it appears on the surface.

The reported deficit understates the real situation. In 1988, for example, the reported deficit of $155 billion actually consisted of a surplus of $97 billion in the trust funds, and a deficit in the general funds of $252 billion. And estimates for fiscal year 1989 and 1990 show the same situation.[3]

If I could refer you to Chart 1. There you see the first three lines showing the revenues, the outlays and the total deficit on a unified basis, which is the type of budgeting and accounting the Government went to in 1967.

Chairman **GLENN**. Could I stop you just a moment there?

Mr. **BOWSHER**. Yes.

Chairman **GLENN**. We had copies of these made last night. I knew that they would be facing us. We did not have time to get additional charts made so the audience could see.

We passed them out there. If anybody does not have a copy of these charts they are available there at the table.

Thank you.

Mr. **BOWSHER**. So what we are trying to show this chart is what really makes up the components of the deficit at this point. And if you look underneath, in the bold letters, we have the Federal Funds Deficit. And that is really what the deficit is currently at if you take out the trust fund surpluses. And the trust fund surpluses are shown right below.

In fiscal year 1986, you can see that the trust fund surplus for Social Security was $17 billion. If you move across that line, you can see that it is growing to being $63 billion in 1990.

Now, the other trust funds are large, and you can see even much larger than Social Security in fiscal year 1986. But it does not have the dramatic growth as you move along to fiscal year 1990.

But when people talk about the progress that we have made from coming down from a $221 billion deficit to the $150 or $155 billion on the unified basis, what they are overlooking, lots of times, is how much of that is really a result of the increasing surpluses that are being developed in the Social Security and other trust funds, primarily from the payroll taxes that we are taking from the workers and the businesses in this country, which was intended for Social Security. And what we are really doing is we are using that money to pay for current Government operations.

That is a story that I do not think is fully understood, and I think it gives you a clear indication here why we believe that the budget deficit at the Federal level is more serious than the official records would indicate.

---

[2] See p. 76.

[3] See charts 1 and 2 on pp. 97, 98.

Another way to look at this is shown on Chart 2. If you begin with the lower line, that is the Gramm-Rudman targets, bringing you down to a balanced budget in 1993. If you look above that on the dotted line, that is the CBO's projection, its most recent projection of what they think the budget is going to do through the 1993, 1994 period. And then the gray area is really the Social Security trust funds that are going to be used. You can see that that is a growing part of the solution to the budget. And if you did not have that, you can see that the trend line for the Federal budget is really up rather than down.

So one of the major things I hope I can get across today—and we are going to be issuing the report next week to Senator Moynihan, which he requested. We hope that report will clarify for everyone just what is the budgetary impact of the Social Security trust funds, and what are some of the problems we are getting ourselves into as we use these trust funds as operating funds.

Now, I was speaking to a business group last night, and the way I tried to portray it there is that: If you were a bank, it would be like taking in deposits, and counting them as income—which I do not think makes a lot of sense.

Another way to look at it is if you were a corporation and you were using your employees' pension funds to pay current operations. You would be in a lot of trouble with the SEC and the Government. And that is exactly what we are doing.

Now, the original idea in all this, when the Greenspan Commission fixed the Social Security trust funds, the plan was to build up reserves through the 1980's, through the 1990's, and be ready in the next century to be able to handle the demographic situation that is going to happen when we have a lot of people retired and fewer people working. But when we are spending the money to fund our current operation, needless to say, we are not really building any reserves. What we are building is bookkeeping entries.

In other words, we do actually make a bookkeeping entry and issue a bond to the trust fund, but truly there is no cash, there are no assets literally to support that. So when the Social Security trust fund is needed in the next century and it says, "We need the money now to pay the pension," we really do not have the money there. So you are going to have to increase taxes at that time or dramatically cut Government operations or something like that.

So this is one of the things we hope to make clear here—and we have got it in our transition reports. I also think the report that will be issued next week on the Social Security trust fund really lays this out. I think this is one of the major problems facing the Federal Government.

If I can continue, then, in addition to this situation, there is an explosion of unfunded costs, much of which are unavoidable. These include the $50 to $100 billion needed to solve the savings and loan crisis, between $100 and $150 billion needed to clean up our aging nuclear weapons production complex, and $13 billion more than estimated to modernize our computerized air safety system.

Even though DOD will likely have to live with constrained budgets, each of the military services says it needs billions more to complete modernization and expansion programs. Some hard decisions on funding levels must be made. Major weapons systems are experiencing cost overruns and technical problems which will have to funded and solved.[4]

What we tried to do on the third chart was to lay out some of these major problems that the Bush Administration and this Congress will have to deal with that were really not in the budgets when the fiscal year 1988 ended on September 30th. Some of this has been dealt with in the Reagan budget submission, but these are the really big items that we know about—and the Congress now knows about—that will have to be dealt with. I think, as you can see, there is a lot of money there.

The reason we have the two question marks on the DOD weapon systems and the bowwave is because we've not had time to examine the submissions of the Defense Department at this time.

But the bowwave, as of this past summer, was what we figured in the range of about $200 billion, and that is because in the early Reagan Administration years, we had this very big buildup in the defense budget. We went from $140 billion to $280 billion. We doubled the size of the defense budget in 4 years. And the plans were at that time that that would continue, that buildup would continue. Actually, when Gramm-Rudman came in, that was the end of the big buildup in the defense program. And what was needed at that point was to make the tough decisions to take out the weapons and the increases to get the 5-year plan, the future 5-year plan back to something that was close to what the Congress and the administration could afford for defense.

That had not been done in the last 2 years. We didn't get the fit-up; we didn't get the information from defense. Hopefully, as this budget comes over and as we get the fit-up for the Defense Department, much of that will have been accomplished. But I think that is a very important area for the Congress, primarily the Armed Services Committee and some of the other Committees, to zero in on as to what is happening to bring back the future weapons plans and force levels to live within the more constrained defense budget.

Chairman GLENN. Now, your $263 billion deficit that you showed on the other chart, none of these unfunded costs were reflected in that $263 billion. Is that right?

Mr. BOWSHER. That is correct, Mr. Chairman.

Chairman GLENN. So whatever per year we apply on each one of these problems here is going to be added to that deficit, I presume.

Mr. BOWSHER. That is correct—well, no, let me go back. It is not included in the $253 billion and not really included in the $264 billion. There might be some of it in the $263 billion for fiscal year 1990 in the budget that has just been sent over by the President. But a lot of it is not in there.

In other words, most of the funding for the nuclear weapon program is not in there, and only a small amount for the S&L bail-out.

The budget problem requires a carefully developed, politically sustainable, multi-year budget strategy. All parts of the budget should be negotiable. The goal should be to reduce the deficits in the general fund and to move toward approximate balance or surplus in the unified budget at a steady and sustainable pace.

---

[4] See chart 3 on p. 99.

The agreement on strategy must be sufficiently specific to be meaningful, but flexible enough to allow for changing conditions. The negotiators must work with realistic estimates of cost, including recognition of some known budget threats and with credible economic forecasts. Additional revenues are probably an unavoidable part of any realistic strategy for reducing the deficit.

Our third transition report discusses revenue options frequently proposed. Because each option alone has some drawbacks, a combination of these options could emerge. Both Congress and the administration must begin to view and address problems from a longer-term perspective, rather than focusing on short-term consequences and "quick fixes" that often result in even more serious problems down the road. Both central and line agencies must assume responsibility for operational problems.

Something is basically wrong with our approach to making budget and management decisions to have allowed some of the problems such as I described earlier with our delivery of vital Government services to have existed so long. OMB is a key agency, as you pointed out, Mr. Chairman, that must change to help improve the situation.

In reality, OMB's approach is a product of the way the entire Government looks at problems and issues. Presidents, the Congress, and the agencies all have to share the responsibility. But OMB is the key agency in the Executive Branch that should have the foresight and the perspective to understand the long-term implication of not adequately addressing these problems. Unfortunately, OMB's history, recent history, has mitigated against it taking this longer-term perspective. And, partly because of that, poor decisions have been made.

To help reverse the disinvestment in people and management systems that has occurred, I would like to point the Committee's attention to some of our transition reports that deal on a Government-wide basis with this issue.

For example, as a foundation for dealing with the "people problem," our report on the public service urges a rebuilding of the image of the public service, changes to address the pay and benefit structure, and making ethics in Government a priority of political appointees. We cannot continue to expect to make progress in this area by saying that all solutions must be "budget neutral." We also cannot continue to require that agencies absorb the costs of all pay and benefit increases. OPM needs to take a more effective leadership role in helping assure that the Federal workforce is up to the task at hand.

To manage costly, and often one-of-a-kind, Federal computer systems effectively, our report on information technology issues urges greater agency top management attention to the role and importance of strategic planning and the need to control specific projects through each phase of initiation, development, and operation. Currently, there is a Government-wide shortage of technical staff in this area. To deal with this situation, we urge in this report the establishment of special salary scales for technical personnel, along with other better planning actions.

I might say that we had Paul Volcker over for breakfast this morning at GAO to discuss some of these issues, and I think some of these he is going to be addressing in the report that they will be issuing shortly out of the public service commission.

Now, there are many facets to be considered in improving the Government's financial and budget affairs. I believe a broad restructuring and rebuilding of our overall financial management structure is essential and deserves a top priority of the new administration and Congress. To be most effective, reform must be Government-wide, serving the needs of both Congress and the Executive Branch. As discussed in some detail in our transition report on financial management issues, modernizing the Federal financial management structure means we need to consider restructuring the budget to include capital and operating subtotals, and we need some sound financial accounting and reporting, effective internal controls, and strong auditing of financial information and program operations.

Over the years, GAO has pointed out the need for improvements in the structure and the content of the budget. For example, in testifying last year before this Committee, I said that particular attention needs to be given to developing a budget that better distinguished between capital and operating amounts. I noted that by combining capital and operating amounts, the current budget structure blurs an important distinction which can result in a bias against major long-term investments, such as replacing the Government's antiquated computer systems. Some of the very costly modernization projects discussed in our transition reports, which I have already mentioned, further point out the need for a separate budget for proposed long-term capital expenditures.

Chart 4 illustrates how the revised budget may have looked using fiscal year 1987 numbers.[5] If I can go over to Chart 4, if you look at the far right, where we have the "Total" column, that is really how the budget is summarized now, except you don't have the split between the capital requirements and the operating expenses.

What I really think we need is to look at what is the general operations of Government, which would be the first column; what is in the trust funds, which is the Social Security trust, the Medicare trust, the military and civilian pensions, the highway trust funds, the airport trust funds, the FDIC—that would be in that column. Then we have certain enterprises that we run, like the Post Office and some other large operations. And I think we should have that column. Then I think you would have a proper breakdown as to what is really happening in the Federal Government and where the deficits are really occurring.

As you can see in the general column, in 1987 we ran a deficit of $163 billion. Then we needed $58 billion more to finance our capital improvements. That is how we got up to the total deficit of $221 billion. But you can all see that with this kind of a structure, you would see right away how much of the surplus is coming from the trust funds.

I think at that point, then, you could start to really zero in on what has to be addressed if we had some kind of a breakout like that. Now, there are other types of breakouts that might be similar to that, but this is our best thinking at this time.

---

[5] See chart 4 on p. 100.

Now, in all of these areas, OMB and key line agencies have roles to play. OMB needs to understand much better the problems agencies have and what it takes to solve them. It needs to work closer with the agencies to develop a longer-term financial management strategy to get there and better explain to the President and the Congress the consequences of not following the long-term strategy. It needs more professionals to do this job well.

Right now, Mr. Chairman, we are doing a management review of OMB. It is amazing to me how small the organization has gotten. They have over 300 professionals today of which I guess about over 200 work on the budget side. And that is not a very large number to try to follow the entire Federal Government. So I think this is one area that is going to have to be addressed.

Now, I think OMB teams, which blend program and management expertise during the budget process are critical to successfully changing OMB's approach. Equally important, however, is the commitment of the President and OMB leadership to such efforts.

Another key to management progress is not to use just OMB, with its limited staff, to impose change or attempt to manage agency operations. Rather, the administration must enlist the commitment of the line agency executives to address very difficult problems. OMB can play a useful role in demonstrating the existence of a problem, providing the necessary policy framework to guide the agency efforts, providing the external influence and support useful to agency officials in overcoming opposition to change within agencies; and, finally, coordinating those issues which cross agency boundaries.

However, the agencies bear primary responsibility for addressing their own management issues. OMB's efforts should not be seen as alleviating the accountability of agency heads for addressing agency problems and successfully carrying out long-term plans and programs within fiscal guidance.

In conclusion, Mr. Chairman, many of the problems facing the Congress and the new administration are critical and many of them are immediate. We look forward to working with your Committee to help the Congress address these problems.

We would be very pleased to answer any questions at this time.

Chairman GLENN. Thank you very much. We appreciate that.

At least for the first round here, we will go on 5 minutes on the first round here so everybody gets a chance for early questioning here in case they have other commitments.

What efforts have you made to present your work and all of these reports here to the Bush transition team and members of the incoming administration?

Mr. BOWSHER. As soon as we published the reports, we sent them over to the transition teams.

I might point out that we were in contact with both parties, both presidential candidates, this fall as we were putting these together. And so our agreement with both groups was to deliver the reports just as soon as we could after Election Day. And so we did. We delivered them to the transition team under Chase Undermeyer at that time, and we then delivered them to the Cabinet people as they've been named. And we have had meetings with Mr. Brady and Mr. Darman on the economic issues. We have had two meetings with each of them. And we are trying to meet with all the Cabinet officers and all the agency heads as they are named.

So far, we have not had many of those meetings just because they are so busy with their confirmation process and other things like that. But most of them have indicated that they want to get together with us soon.

Chairman GLENN. The response has generally been good, then.

Mr. BOWSHER. Yes, it has. It has been very favorable.

Chairman GLENN. Good. We have a hearing tomorrow, as I said, with Mr. Darman right here. I do not know whether we will be able to complete all of his confirmation hearing tomorrow or whether we have to carry over until Monday. We will try and do it all tomorrow. If not, we have a backup day of Monday set aside for that, too.

What approaches would you advise Mr. Darman to take to achieve budget deficit reduction that would be different from his predecessors? You have stated the problem here very well.

Mr. BOWSHER. Yes. We think that if you are going to get at this problem—which we think is a very, very large problem, bigger than the official figures indicate, as I mentioned before—that you are going to have to have a multi-year approach.

I other words, I think one of the weaknesses of Gramm-Rudman—and I am not recommending to do away with Gramm-Rudman, but one of the weaknesses of the Gramm-Rudman process is it is a snapshot, it is an annual snapshot. And I really think that if you are going to get on top of this problem, you have to do it on a multi-year plan which I think the administration and the Congress have to agree on.

I do not think we will make a lot of progress here unless you can have an agreement between the Congress and the administration as to just how they're going to bring this deficit down.

I think you have to have all the big issues on the table. I do not think you can solve a 200-plus billion dollar problem if you take most of the big items off the table. And so I think that in the negotiations, I think it would be good if everything was brought back on the table and looked at. And if you could work out some agreement over a several-year plan here, I think the job is doable.

Chairman GLENN. Do they need to make some changes on just how information comes into OMB? You have identified in the past here the fact that we have over 400 separate, different accounting systems in the Federal Government.

Mr. BOWSHER. Yes.

Chairman GLENN. How on earth can OMB know what they are doing if they do not even have one accounting system that can talk directly to another through the computers or whatever? It is a real morass out there. Do they need some structural changes to even get their hands on the problem?

Mr. BOWSHER. Yes. I really believe and have strongly recommended, as you know, Mr. Chairman, redoing the accounting systems of the Federal Government because they are old, they are antiquated, and many of them go back in concept to World War II and the early 1950's. And I think to have a proper information flow as to what is really happening out there, any organization, any large organization needs good information as to how the money is being spent and what is really happening.

Then, secondly, I think you need to have enough staff over there at the OMB to be able to get out of the building and to go out and to find out what is happening in these departments. And I think, unfortunately, what has happened in recent years is GAO has become more the organization that reports major problems; and I think it would be very beneficial if the Executive Branch had enough capability at OMB, including program knowledge and management capability, to know really what is happening in these departments and what are some of the problems that are developing.

I think the S&L crisis is a good example. That was a crisis that began to develop, and the Loan Board was not anxious to recognize that they had a problem. But when they finally did, why, I believe Chairman Gray went over to OMB and asked for resources, and he did not get a lot of help. And that problem today has now become a huge problem—not that it was OMB's problem alone, but that was one of the factors. We just did not provide the resources to properly supervise and audit and regulate the S&L industry.

I think the same thing happened, Mr. Chairman, with the nuclear weapon systems. To allow that to happen over as many years as that has been building up now leaves us with a very big program. And computer systems, I think computer systems are awfully important in some of the very key departments of Government: the IRS, the Social Security Administration, the FAA. And if we do not have those systems working and being modernized, we run into real program problems down the road which can cost a lot of money.

Chairman GLENN. My time is up. Just a comment, though, before I pass it over to Senator Levin.

We have worked with you before on having a chief financial officer for Government, which I know you very much favor. I presume you still do. You have testified to that before, someone to bring control to this thing. We are going to be reintroducing that again this year, so we will be wanting you to give us some counsel and advice on that as to whether we go with the previous request from the adminstration that it be in Treasury or whether it should be in OMB.

Senator Levin

Senator LEVIN. Thank you, Mr. Chairman.

First, let me commend you on the initiative that you have taken in producing these transition reports. I am curious as to what reaction, if any, you have received from the transition people of the Bush Administration.

Mr. BOWSHER. Yes, it has been very positive. They have read them; they have used them, they tell me, to even consider who might be asked to come in to hold Cabinet posts. So they have been very positive in their reaction to the reports.

Senator LEVIN. Now, specifically, what has been their reaction to your charts or your points relative to the Social Security trust fund being used to mask the deficit?

Mr. BOWSHER. We went through that very carefully with Mr. Darman and Mr. Brady very early on. And I must say, they asked good questions, they listened, and they looked worried as we took them through the numbers.

One of the reasons we also did this transition series was that I was always very concerned about what happened in previous transitions. When President Carter came into office, he was presented the official projections which showed that he could easily move into a surplus position in his second or third year of his administration. And if you remember, that is what he said he was going to do.

President Reagan was shown figures that showed positive surplus positions in 1985, and we ended up with, you know, $200 billion deficits.

I think one of the problems—and this is what I said to Mr. Brady and Mr. Darman—is that the official figures do not show the real, true financial picture of our Government, and that is why I wanted to take you through these numbers. And they listened very well that day.

Senator LEVIN. In addition to looking worried and listening, did they say anything about their position on it?

Mr. BOWSHER. No, they did not indicate to us what their solutions or their positions would be. Of course, it was very early on.

Senator LEVIN. Do you recommend a separate budget for Social Security?

Mr. BOWSHER. What we recommend is that last chart I had up there. In other words, I would keep the unified feature in the budget so that you know what the total economic impact of the Federal Government is on our economy. I think that feature of the unified budget makes sense. That is the last column.

But I think unless you have that kind of a breakout which does separate trusts, like Social Security from your general operation, I think you are masking a lot of problems.

Senator LEVIN. Well, putting aside the technicalities, when you say "separated," are you saying, then, that we should not count the trust fund surpluses towards the Gramm-Rudman targets? Is that what you are basically saying?

Mr. BOWSHER. I think eventually it would be better to have separate targets myself.

Senator LEVIN. Not eventually, because we are going to get to zero using these surpluses in 1992.

Mr. BOWSHER. Yes.

Senator LEVIN. And it is going to mask the deficit if we do that.

Mr. BOWSHER. That is right.

Senator LEVIN. So the eventuality will come too late to have any impact on the Gramm-Rudman targets if we wait until 1993.

My question is: Why not now? Why not right now say that we are going to unmask this, we are going to make these truly trust funds? Right now, they look like breach of trust funds to me.

Mr. BOWSHER. I think it is one of the things that should be considered as you work out the budget agreement.

Senator LEVIN. What would be your recommendation if we consider that?

Mr. BOWSHER. I would think that one of the things you would want to consider is some kind of a multi-year plan to get those numbers down in some kind of a breakout that would keep the trust funds separate from the general operations.

Senator **Levin**. So the only way we are going to do it is if we have to do it.

Mr. **Bowsher**. Yes.

Senator **Levin**. And the question is: Should we put ourselves in a position where we cannot count those surpluses towards the Gramm-Rudman targets? That is the hard question, it seems to me. Do you have a recommendation?

Mr. **Bowsher**. Okay, but then you have got to change the Gramm-Rudman targets. Then I would agree with you?

Senator **Levin**. If you change the targets?

Mr. **Bowsher**. Yes, because you are working with different numbers. In other words, you have got to get different numbers than that.

Senator **Levin**. Would you change the targets by as much as the surplus?

Mr. **Bowsher**. Well, I think we have got to get into a net surplus position in the early 1990's if we are going to have any ability to get on top of this problem and to really build some reserves for the Social Security.

Senator **Levin**. Because I am going to run out of time, let me just suggest that you give us, if you would, your specific recommendation on how you would handle these trust funds relative to the Gramm-Rudman targets in the next few years. It is an absolutely critical question, it seems to me. And, if you could, give us your specific recommendation. If you want to change the targets and not count this, tell us what you would change those targets to.

Mr. **Bowsher**. All right.

Senator **Levin**. Can you do that?

Mr. **Bowsher**. Yes.

Senator **Levin**. What intrigues me about your reports generally is, number 1, how good they are; and number 2, how they tend to dissipate their effect, or we tend to allow their effect to be dissipated by not getting the agencies' responses promptly and in a way that we can compare the recommendations of your agency versus the response of the agencies that are being analyzed.

Do we have or could we put into place a better mechanism to get your recommendations and the agency responses together so that we can really see where the conflicts are? I find over time that we tend to have the agency response on paper at least, but we do not really have the two positions together, pitted against each other.

Is there something we should do differently relative to those reports of yours?

Mr. **Bowsher**. Well, one thing that happened was that in 1980 you did pass legislation to force a formal reply, and that was very helpful. That was a big improvement.

One of the reasons we put these reports together the way we did is we thought that the Committees could use them more in the oversight role by providing what GAO thinks are the major problems, and then to have the agencies come up and discuss them. And I thought that what we would be doing is getting the oversight role on the bigger problems. In other words, so much of our congressional request work, I think, lots of times focuses really on some small scandal or some small problem that looks bad right at that point. But what I was driving for with these reports was:

What is the three, the four or the five biggest problems in the Transportation Department, the Justice Department, the Energy Department?

It seems to me that one of the things you might want to do is to have reactions on these reports from the agency, which we did not ask for. But if Congress wanted to get to the major issues, I think, that would be one of the approaches.

Senator LEVIN. Thank you. My time is up. That suggestion may be useful.

Chairman GLENN. Good. Senator Lieberman.

Senator LIEBERMAN. Thank you.

Mr. Bowsher, may I tell you that, from a distance, back in Connecticut I have admired the vigorous way in which you have done your job. It is a pleasure to have the opportunity to now work with you directly, particularly as a member of this Committee.

Mr. BOWSHER. Thank you, Senator.

Senator LIEBERMAN. Being new, I have the luxury for a period of time, anyway, of asking simple-minded questions, and I will avail myself of that luxury.

Chairman GLENN. Simple-minded questions are not the priority of new people. They do not belong only to the new people around here. [Laughter.]

Senator LIEBERMAN. Thank you, Senator. A typically gracious response from you.

One of the things that strikes me as I listen to your comments about OMB, if I hear you correctly, is that the agency has spent a lot of time on the "B" and not much on the "M." They have worked a lot on the budgeting but not much on the management, in part because they are inadequately staffed to do that.

I have a simple-minded question, stepping back and looking at this trillion dollar-plus operation. If I may, coming from 6 years as Attorney General of Connecticut where I had about 300 employees, one of my major worries was how I was going to be certain that they were doing what they were supposed to be doing efficiently in the interest of the public and the taxpayers.

What systems exist in the Federal Government at this time, system-wide, Government-wide, to guarantee a review of the way in which statutory responsibilities are being carried out? Is there any ongoing review, or is it entirely apart from the excellent work that you do? Is the rest of the responsibility with OMB?

Mr. BOWSHER. Much of it does rest with OMB, but one of the problems you have is you have such a mixture of systems in the various departments, and you do not really have, generally, a good reporting system of the major program issues. I often use the SAR reports at the Defense Department as an illustration. This is for the weapons systems.

In other words, after the C-5 cost overrun of 1968, people went back and they looked at all the submissions, the budget submission and everything else; and they realized that there was no real reporting on that weapon system as it was getting into financial trouble and as Lockheed was getting into financial trouble.

So we started a new system at that time. I was serving as Assistant Secretary of the Navy at that time. We started a new system to report to the senior people at the Pentagon and to the Congress as to where we stood, schedule-wise, the technical milestones, and on the cost. The concept of the system was good. The information was very helpful at first. But the system was allowed to get into dis-use over the years as different administrations came and went. So as a result, every new administration that comes in has a surprise, and that is why we had that one question mark up there for cost overruns.

In other words, right now, one of the things that I recommended strongly to Mr. Darman and Mr. Brady is: Have the new Secretary of Defense ask what cost overruns do we have now on our major weapons systems? We have about 80 to 100 major weapons systems in the Department of Defense, and the reason they get to be a major weapons system is they are going to cost more than a billion dollars apiece.

So that is the kind of information that I think is crucial that the Congress, the leaders of Defense, OMB, and the President have so that they know what is happening over there on these weapons systems. Unfortunately, over the years, that system has been allowed to, you know, be good at times and go into dis-use at other times. And there are a lot of congressional people who are very frustrated with it. That, to me, is the kind of information flow that you need for this trillion dollar operation.

Senator **Lieberman**. That example is an interesting one, because the creative management response really came from within the department in that case. I take it that there was no one at OMB, for instance, overlooking or looking over your shoulder to come in periodically and prod you to do something like that. That was a result of your own initiative.

Mr. **Bowsher**. That is right, and then the prodding like that just does not take place very often.

Senator **Lieberman**. I know that some of the departments have an Office of Inspector General.

Mr. **Bowsher**. Yes.

Senator **Lieberman**. How do you evaluate that role?

Mr. **Bowsher**. Well, I think the Office of Inspector Generals have worked quite well, actually. It is a new office in each of the departments. They have been in place about 10 years in some of the departments. And I think that really has helped with some of the information flow, and I give OMB high marks for having pulled together the IG's in a council that they work together and try to get some of these problems identified. And so that has been one of the positive developments of the last 10 years.

Senator **Lieberman**. Have the IG's tended to function on management systems or on fraud and waste, or both?

Mr. **Bowsher**. A lot on fraud and waste, not as much on management systems.

Senator **Lieberman**. Do you have any guess as to what would be an adequate level of staffing for OMB to begin to realize the kinds of goals for it that you have?

Mr. **Bowsher**. At one time there were about 600 employees at OMB, and I had a sense that they had more time then to get out and work with the agencies and to understand the programs better. Whether that would be the right number, I think it is a good question to ask Mr. Darman tomorrow. I really do.

Senator LIEBERMAN. And now there are 300? Did I hear you correctly?

Mr. BOWSHER. Three hundred seventy-eight in professionals. That is right.

Senator LIEBERMAN. Thank you.

Chairman GLENN. Senator Kohl.

Senator KOHL. Well, this is a first-time experience for me, Mr. Bowsher. I have never had a chance to question a witness because I have never been an office-holder before today. So I will never forget you. [Laughter.]

I come from the world of business, primarily. I was involved in business in Wisconsin for many years. We had about 100 retail stores and 6 or 7 thousand employees and did very well over many years. Of course, we learned that the techniques of being successful in business required us to make both short-term and long-term plans. We couldn't be so concerned with profits in the next quarter that we neglected what kind of company we were going to have in 5 or 10 years. We had to make the kinds of decisions that best reflected the interests of our employees and our company over a period of time. We had to provide the kinds of incentives and the kinds of checkpoints that made sure that, you know, our company was successful over a period of time and not just for a moment.

And it worked. I mean not just in our particular company, but it works in most successful companies around the country.

This Government is the biggest business in the world. At the same time, I realize that Government is more than just a business; still many of the principles that you operate under are the principles that govern a successful business.

Again, as Joe is a first-time person, I am even more of a first-time person here in Washington. Why is it that we are so unsuccessful in bringing to bear those concepts that are used in successful businesses across the country? Why have we been so unsuccessful over the past 10 years in being able to run our Government effectively and efficiently, both with respect to raising revenues and with respect to delivering services?

Mr. BOWSHER. There are two or three, I think, main reasons, Senator. First is the budget deficit. People often ask me, what is the consequence of these large budget deficits? And one answer I always give is it puts us in a position of always shortchanging the investments we have to make to run our operations well.

In other words, if you are going to take in a trillion dollars of income, you have got to have an IRS that has good computer systems in this day and age.

We had one of the service centers outside of Philadelphia just about collapse 2 years ago because of some problems with that computer system out there.

And that is the kind of thing that just should not happen, but I think over the years here, in the last 10 years, with such a large deficit, lots of times, when people come up and say we have got problems, we need money to do this, or invest in this kind of people, why, the tendency of the budget people is to say we do not have money. And that is really what is going on right now, I think, in the nuclear weapons programs.

I think that the Energy Secretary, Mr. Herrington, and I suspect, Admiral Watkins, now, when he takes over, is going to want to really get on top of the problems that we have in the 16 plants around the country, huge plants to build these nuclear weapons.

And yet the tendency will be, by the budget people, to just give him as little as possible because of the large deficit. In other words, they just are going to be very concerned about how much do they have to put in on an annual basis.

But as you know, from being in the business world, if you have got problems and you do not face up to them, lots of times that problem gets bigger, and so that has happened.

The second thing I think that has happened over the years is that maybe the Federal Government, and other Governments even, to a certain extent because of pay and other situations, have not been attracting the top technical people that you need today in many of the areas.

In other words, in nuclear weapon systems, in computer systems, and the FAA, and the systems to give us air safety in this country, that takes very qualified people, and I often say that the private sector does not fully realize that when the Government does not work well in some of these areas, it is very hard, then, for the private sector to work well.

I think the banking systems today are seeing a good illustration of that. And so we have got to be able to attract good people, and we have got to invest in some of these, what I call very key operations of the Government, and we just have not been doing that wisely.

Another illustration is that even where some of the money was invested in the nuclear weapons complex, it was not done wisely. For example, we built a new plant—Dexter, you might add to this—out there in Rocky Flats. It has never come on line. The design was faulty, so, you know, millions of dollars went into that investment, but when you cannot bring it on line because of design problems, that is just money right down the drain.

I think a lot of American taxpayers are going to be very concerned about this S&L bailout. I think there is going to be a tremendous outcry by the people when they realize how much this is going to cost, and you are not getting much for it.

The same with interest costs. We have run up our debt now to $3 trillion. We are paying a huge interest cost every year, $150 billion, or more, for really, the privilege to pay it again next year.

That is about what the interest money accomplishes. And so those are the problems that I think that we have got ourselves into with this very large deficit, and it is not easy to work yourself out, and one of the places you do is you short-change places when your agency people come to you with major problems.

Senator KOHL. That red light I presume means my time is up. I will just make the comment—and maybe I will get back to it when I speak to you again—I do not think we have focused on the responsibility of real people who have real responsibilities, here, in Washington. You know, myself, yourself, and all the rest of us who have a responsibility to take in "x" dollars and to spend no more than "x" dollars.

In the main, we know what we are taking in. These figures that we are looking at today, and we have looked at over the last several years, are not new: responsible people at all levels of Government are very much aware of these problems, and the fact that we are not responding to them I think is really serious business.

That is why we are here today, obviously. That is why we have come to Washington.

Mr. **Bowsher**. That is right. Yes.

Senator **Kohl**. I think that for whatever reasons, we evade our responsibilities, and then we have pretty dire consequences which we are facing right now, and I think we are touching on them, but they are all problems created by people.

Mr. **Bowsher**. That is right.

Senator **Kohl**. Many of them are here, in Washington, and we need to solve our problems.

Mr. **Bowsher**. I agree with you, Senator.

Chairman **Glenn**. Your supposition that DOE has been trying to get the money and ran afoul of OMB I think is absolutely correct. I think it took a while to get DOE sensitized on the nuclear weapons problem. In fact we have been working on it for many, many years.

And they finally got religion on that, and for the last couple of years have been working very hard on it, and I have been complimentary to Secretary Herrington and the other people over there, Mr. Salgado, and Wade, and some of the rest of them for their efforts.

But that is exactly what happened over there. They tried to get enough money in this upcoming budget to at least start on the job, and ran afoul of OMB, and got their funding request cut back to only about one-fourth of what DOE testified before this Committee last summer was going to be needed to even start addressing this problem.

And we have all the facts and figures on that that we have gone over. I have been much involved with that in recent months.

But where they are up against the long-term aspects of what should be done versus the current budget, the current budget prevails, and the things that you mentioned here about how we are going to address all these unavoidable costs up here, of nuclear weapons, or whatever, that is a very real one. We do not have the answer yet. I hope we can get some information from Mr. Darman tomorrow about how he plans to approach it.

I do not think the Reagan approach to this in the budget that was submitted is adequate at all. It does not even begin to address the problem.

During the presidential campaign, President-elect Bush's proposal for a flexible freeze was often linked to the notion that we could grow out of this budget deficit if we just held on long enough here. It did not make that much of a difference.

As I understand the proposal that deficit would be eliminated without raising taxes or reducing Social Security by holding the growth in the non-interest, non-Social Security portions of the budget to no more than the rate of inflation.

From your look at this, do you think that strategy is plausible at all? Will that work?

Mr. **Bowsher**. Well, when you look at history it has not worked. In other words, take the agriculture problem that developed in the mid-1980's. What you really had was not only a reduction in the prices that the farmers were getting, but also a terrible financing crisis in the farm community.

Namely, interest rates shot up to 13–14 percent lots of times for mortgages and they did not come down very fast because you had a farm credit system that was in trouble. As a result the system could not bring their rates down as fast as what was happening in the capital markets.

And so the farmer was really in very, very bad shape out there. So the Reagan Administration and the Congress had to react to that situation, and they did, and we saw the agriculture program go from $5 billion to $20 some-odd billion, and now we have got to work that back somehow.

But those are the kind of crises that hit you, and I think hits every Administration. You do not know, lots of times, where it is going to come from.

But one of the reasons why, again, we did these transition reports, is that we wanted the new Administration to know that there are some big unfunded problems in the pipeline, and you do not get those by trying to hold it to the inflation slope. It just will not work.

Another story I might tell you to illustrate that is, that in 1968, when I went through the transition at the Pentagon, Mel Laird was the new Secretary of Defense, from Wisconsin. He inherited that cost overrun of the C5A, and he was smart enough to ask the question, well, if I have got one big cost overrun, how many more do I have here in the major weapon programs of the Defense Department.

And when we got done totaling it up, for all three services, the total was something like $16 billion.

To put that in perspective, the budget for the Army, the Navy and the Air Force in those days, for each one, was about $23 billion. So what that meant was the new Administration inherits cost overruns on those weapons systems that could be practically as much as one of the service budgets.

Well, that is the kind of thing that kills you when you are trying to hold everything to an inflation slope, you might say.

You also have so much of your entitlements rooted in law. Medicare, the whole health care area, consists of entitlements that have far outstripped inflation in recent years.

So unless you get program changes that are going to get on top of the Federal health care costs, you are not going to keep that big area.

And so, when you look at the major components which make up 75 percent of your Federal budget, it is hard to see how that inflation slope is going to be the controlling factor.

Chairman **Glenn**. With the budget crunch the way it is, what I have been afraid of is if the flexible freeze is to be our policy, we are going to have all these optional items, the long-term unfunded costs that we face flexibly frozen right out of the budget. That is going to be what happens to them under a flexible freeze, I am afraid.

Mr. BOWSHER. Yes.

Chairman GLENN. One of the criticisms of some of your reports has been that they focus only on the total costs of doing whatever job needs to be done, and do not bring the analysis down to an annual cost basis that we have to deal with here.

Can you give us ball-park annual estimates how much these problems will cost to fix? And since my 5 minutes is up, please be as brief as you possibly can.

Let me add one thing, just while I think of it, too. Senator Sasser, Chairman of the Budget Committee, could not be here this morning. He has a statement he wanted to make a part of the record.

Without objection, that will be included

[The statement of Senator Sasser follows:]

OPENING STATEMENT OF SENATOR SASSER

Comptroller General Bowsher, as always, the testimony you have submitted today is clear, concise and to the point.

Like you, I am hopeful that this year will be the year that Congress, working with a new administration, can break this fiscal stalemate that we have experienced in the last several years.

As your testimony points out, in the past decade too often the Reagan administration did not invest wisely in key operations. By focusing on short-term results and keeping a "hands off" approach to Federal regulation, long-term public sector problems were created.

Now, in the new decade ahead we are faced with unprecedented budgetary and economic challenges for our country.

The mammoth proportions of the budget deficit, in addition to the enormous—yet unfunded—costs associated with the crisis in the savings and loan industry and the clean-up and modernization of nuclear weapons complex represent a test of leadership that will in considerable measure determine the success or failure of the fiscal policies of the incoming administration.

Fortunately for us in Congress, the General Accounting Office has clearly outlined the scope and breadth of the problems facing the new administration. The testimony presented today and the series of transition reports put out by GAO offer clear and cognizant views and suggestions on how best to address the many critical problems facing the country.

I strongly agree with GAO's contention that addressing the budget deficit is clearly the first and foremost subject that must be taken up by the new administration and Congress. Furthermore, I agree that deficit solutions require carefully developed policies that are based on credible economic forecasts.

However, as we have already observed, the last Reagan administration budget has failed to follow this simple advice. The administration's 1990 budget proposal relies on unrealistic economic assumptions and ignores some of the most critical long-term economic problems facing the country. It drastically underestimates the deficit crisis and by focusing exclusively on deep cuts in domestic programs, the outgoing administration resurrects a deficit reduction approach that has been rejected repeatedly by the Congress and the American people.

I hope the Bush administration's budget will not make the same mistakes and will submit a budget based on sound assumptions and a realistic assessment of the Nation's present and future needs

As you also made clear in your testimony, many of the problems that are hampering the Federal Government's ability to serve the Nation are not a result of a lack of funds. The problems arise as a result of the way Federal agencies operate. In many cases we must modernize hardware and recruit and retain better trained personnel for essential Federal programs. More importantly though, we must reform the way some agencies plan their priorities, manage their programs and facilities, or regulate operations under their purview.

The crisis in the savings and loan industry is an example of the Federal Government's failure to invest in better regulatory systems.

The enviromental damage and safety problems caused by the deterioration of the Nation's nuclear weapons complex is an example of the Federal Government's failure to provide needed oversight.

The cost overruns and unneeded inventories at the Pentagon are an example of a Federal Government's failure to put in place effective management systems.

Unfortunately, these examples of inefficient, ineffective, or inadequate management structures and regulatory administrations are costing the taxpayers billions of dollars.

It is clear that from the testimony presented today, Congress and the administration must start looking past the short-term consequences of actions. The current deficit problem and the failure to invest sufficiently in or revise key operations of the Federal Government is debilitating the country's ability to provide Americans essential and effective governmental services.

Both the Congress and the new administration should heed the sound political, operational and financial advice, that GAO has presented in today's testimony and in its series of transition reports. They offer a sound blueprint for putting our fiscal and management priorities in order.

Chairman GLENN. I also need to ask, Mr. Bowsher, if your more lengthy statement is to be included in the record?

Mr. BOWSHER. Yes, please.

Chairman GLENN. In addition to your abbreviated statement, without objection, the longer one will be included in the record.

Go ahead, as briefly as you can please answer my question.

Mr. BOWSHER. Well, we did not convert it to annual costs. The purpose of our trying to identify these costs was to look at a more total cost, what is it really going to cost?, probably over the next several years, and then we figure that OMB and CBO can do the budget work of converting it to the annual costs.

So we do not have an annual breakdown. I think your biggest one, though, that will hit you—the couple biggest ones will be the initial amount for the S&L bailout, and a lot would depend on what the Treasury's plan is that they propose, and I think the cost overruns on the DOD area. I think those are the ones that are going to hit very hard and very fast.

Chairman GLENN. I think we are supposed to get the S&L suggestions from Treasury by mid-February. February 15th, I think that is it.

Mr. BOWSHER. I believe that is what I have read. Yes.

Chairman GLENN. Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman.

The Chairman asked you about the flexible freeze, and I want to pursue that just for a moment. From your understanding of the flexible freeze program, what is the level of revenues as a percentage of GNP that will be generated by that program? Is it around 19 percent? Does that strike you as being the percentage?

Mr. BOWSHER. I do not have that figure, offhand.

Senator LEVIN. Do you have, offhand, what level of spending would be required to meet current needs, and to meet some of the items that you have listed on the board as urgent requirements?

Mr. BOWSHER. Not offhand we do not have it. We would have to work that up.

Senator LEVIN. Senator Kohl asked you a question which is a critical question, and that is why is it that we cannot match our spending with our income.

He gave some reasons for that. He did not list the political aspects, and I am wondering if you would want to add to your list, first, that we were tempted by a tax cut that we could not afford because we did not cut spending when we cut revenues with our 1981 tax cut.

Second, that we funded a defense build-up that we could not afford because we did not increase revenues adequately to fund the defense build-up.

Additionally, in response to Senator Kohl's question about why we are not run more like a business with our outlays matching our income, that you might be willing to put somewhere on your list, hopefully near the top, that there is a political payoff in the short-term, not the long-term?

Mr. BOWSHER. Well, I interpreted the question from Senator Kohl more as to the management, why we had not been able to get on top of these problems with the management, but there is no question as far as matching the revenues with the expenditures, that when we did some of the things that you illustrate, Senator—especially the big build-up in defense.

And in the Vietnam War we went from $40 billion to $80 billion. We doubled the size of the defense budget to fight the war, and there was a lot of criticism that we never put on war-time economic policies.

Well, we did the same thing in the early 1980's. We went from $140 billion to $280 billion in 4 years, and as you point out, we cut the taxes and the revenue stream, and there is a lot of debate as to whether the revenue thing—because that still saves that about 19 percent.

But the interest cost, too, I think is a big factor. In other words, when I meet with the military leaders, they always are very discouraged and perplexed as to why they are having such a hard time with their budget when it is a smaller percent of GNP than it normally has been historically.

But as I point out, you have the third tower now in that budget. You have the interest cost. It is a very large item in the budget, and that was created in the last few years here.

And so the political decisionmaking has been, and the reluctance to look at the revenue side of the budget, is a big factor in where we are at today.

Senator LEVIN. And on this masking of the Social Security Trust Fund, you pointed out a situation which has been pointed out before. We are going to have a massive crunch, almost beyond description, when the demographics change in the year 2002, or thereabouts, and instead of creating surpluses we have to start drawing on those funds and the money will not be there.

Or we will have to radically reduce Government, eliminating most of the services of Government or significantly raise taxes in order to keep the deficit down.

Now what you are suggesting we do, it seems to me, is impose on ourselves some short-term pain to avoid that long-term problem. Isn't that the bottom line?

Mr. BOWSHER. That is correct.

Senator LEVIN. You are saying that 10 to 15 years from now we will have a big problem, beyond anyone's comprehension, and if we do not solve it in the short term, we are going to end up with that kind of a problem on our doorstep. Is that right?

Mr. BOWSHER. That is correct.

Senator LEVIN. But that involves painful actions now, does it not?

Mr. **Bowsher**. That is right. You have to make major program decisions on the expenditure side, and you have got to look at the revenue side.

Senator **Levin**. Both.

Mr. **Bowsher**. Both.

Senator **Levin**. So what you are asking us to do, I believe, is to impose some shared sacrifice on the part of the people, some pain in the short-term, for some long-term benefit?

Mr. **Bowsher**. Yes.

Senator **Levin**. And that is the perfect example, right there, on that Social Security chart, is it not?

Mr. **Bowsher**. I think it is. And I think you have to get on top of this problem, now, or if you will end up like the President's budget submission the other day indicates, going to nearly $4 trillion of debt in 1994. Then I think, you know, you are digging such a financial hole that it is going to be very hard to solve it at that point in time, in the mid 1990's.

So I think if we do not solve it now, in 1989, 1990, 1991, we are going to have a financial problem that is just going to be terrible.

Senator **Levin**. Thank you.

Chairman **Glenn**. Senator Lieberman.

Senator **Lieberman**. Thank you, Mr. Chairman.

Mr. Bowsher, I would like to go back to the savings and loan crisis. Arriving here anew, thinking about the budget deficit which of course we are all aware of, I have a sense of climbing uphill.

And as I go on hearing about some of the additional responsibilities that you point to, and that we have been hearing about, it is as if somebody has been throwing weights on our back as we continue to try to go up the hill.

And you know, in a very visceral way, I find it infuriating, as we have a hard enough time trying to balance the budget, not to mention meeting all the public needs that are out there. What I would like to ask you to do is to go into a little more detail about your understanding of why this crisis occurred.

I am particularly interested in the part of your statement where you suggest that OMB may have played a destructive role by denying the request to the Federal Home Loan Bank Board for additional staffing.

Mr. **Bowsher**. All right. What happened was that in the late 1970's, if you remember, when we hit this period of very high interest rates, the S&L industry found themselves in a very difficult situation.

In other words, to attract deposits, they were having to pay more than what their mortgage rates were, their home mortgages. So they came to Congress and said we need some relief, we need to be able to do more with these deposits to earn a higher rate of return.

Congress passed legislation that gave them greater authority and greater ability to do that. Some of the States, then, went and passed legislation that gave them even greater leeway, you might say, to achieve that.

Now what you had at that point was a new industry. It was no longer the historical home mortgage S&L industry that we had for many, many years.

Some of the bank examiners started reporting back to the Home Loan Board that they were finding trouble out there. Initially many of the people who were there resisted recognizing that they had a problem—but once they did recognize they had a problem then they went to OMB and requested——

Senator LIEBERMAN. What was the problem that they saw then?

Mr. BOWSHER. They saw the problem that some of the people were actually making large loans, and they were turning bad.

In other words, as they went in and looked at the loan portfolio, they saw that some of this stuff was just going to be bad, and some of these banks were going to go under.

In fact I watched a program last night on TV, and one of the supervisors pointed out a very interesting point, too, and that is, some of these S&Ls had maybe a $100 million portfolio in 1978, and became multi-billion dollar S&Ls in the early 1980's, overnight literally.

And so to examine them, to review those portfolios was a much bigger job, and you still had the same number of examiners.

So they went to OMB and asked for additional resources. Now, one of the problems was that—I do not remember quite what year it was—but they were turned down.

But then, later on, when the Gramm-Rudman process came in it made it very difficult for anybody to get new resources, because you have to then find somebody else willing to give them up. That is the tough part of budgeting in the Government. And so it did not happen.

And so the agency out there tried to cope with this large evolving problem, and of course the industry itself was denying it.

There were a lot of people here in Washington—when we first issued our reports—who said we were being far too pessimistic, that this was not as big a problem as the GAO was saying it was.

But then, in a year or two, it mushroomed very quickly. So one of the things that Mr. Seidman, who is head of the FDIC, feels very strong about, is—if we could put that last chart up one more time—is that the FDIC and FSLIC should be in the trust fund column over there and should not have to be under the Gramm-Rudman targets in order to do a proper auditing and supervision of these banks, whatever size the banking system gets to be.

And I think that is one of the problems we have today when we treat everything as a unified budget. We are looking at operations sometimes on a short-sighted basis, and that is what I think happened there.

Senator LIEBERMAN. So you think that if the Federal Home Loan Bank Board had more staffing, that the dimensions of the saving and loan crisis would at least have been diminished?

Mr. BOWSHER. Somewhat modified. I am not sure. The other thing that was missing, eventually, too, of course, is when they ran out of cash. Literally the insurance fund disappeared. Then they could no longer go in and really close down some of these organizations, like the FDIC could on some of the banks, and so that is when it really mushroomed.

Senator LIEBERMAN. The red light is on, but I just have one more brief question.

To what extent do you and the people at GAO believe that outright fraud has been involved in the S&L crisis?

Mr. Bowsher. Quite a bit. One of our other Assistant Comptroller Generals—Fred Wolfe—just testified out in San Francisco two days ago on 20-some S&Ls which had been identified by the staff of the House Banking Committee. In practically every one of those cases there was some fraud.

Senator Lieberman. I will come back to it. Thank you.

Mr. Bowsher. Yes.

Chairman Glenn. Go ahead. You have a follow-up. Go ahead.

Senator Lieberman. Just very briefly, what was the nature of the fraud?

Mr. Bowsher. Well, it was a lot of insider dealings. Board members were getting loans to go out and do large developments or large projects, and lots of times it was no longer the home mortgage thing. It was really financing wholly different projects than what the S&L traditionally did.

And then lots of times the bookkeeping was not done in a way that would provide full disclosure.

Senator Lieberman. And there again adequate, or at least more ample Federal regulatory oversight staffing would have seen that earlier or——

Mr. Bowsher. It is often like the New York City fiscal crisis which I was involved in in the mid 1970's. You cannot say that you might have avoided it if you had adequate financial reporting and adequate oversight, but you sure would have known about it. You would have known that it was coming and you do not know what the decisionmaking would have been, but that is what we did not have here.

Mr. Fogel. Senator, I would like to just add one thing. There also has to be a will on the part of the regulator to aggressively get on top of the issue, and once you get the information try to deal with it.

And one of the problems, as Mr. Bowsher pointed out, in the mid 1980's, was that the regulator, the Bank Board, did not show enough willingness to move as quickly as, for example, the FDIC does in banks, to deal with the S&L problem.

So they needed more people to get the information, and they needed more of a will to get on top of the problem quicker than they did.

Senator Lieberman. Why were they lacking the will?

Mr. Fogel. I think that gets into the relationship that the Bank Board has with the savings and loan industry, where it is part regulator and part promoter of the industry.

One of the things that we think has to be looked at is whether that relationship should continue to exist if we are going to have a safe and sound regulation of the S&L industry, and we think that probably the regulator ought to be separated from the group that is promoting the industry.

Senator Lieberman. So basically what you are saying is that because they also had a function of a desire to promote the industry, they did not want to uncover information that would put the industry in a bad light?

Mr. BOWSHER. That is right. They did not want to interpret the information in a bad way. That is exactly right.

Chairman GLENN. Thank you. Senator Kohl.

Senator KOHL. You talked about coming to the table willing to put every item in the budget, except interest, up for discussion.

Mr. BOWSHER. Yes.

Senator KOHL. So are you suggesting that we need to take another look at entitlements, and the manner in which we are handling them.

Mr. BOWSHER. Yes. I think so. I think when you have this large of a deficit, to take entitlements off, or take revenues off, take defense off, any of that, I think it makes it very difficult to address the problem when it is this big.

Senator KOHL. As you and your colleagues have seen this problem mushroom over the past decade—and I am sure nothing anguishes you more—what has happened? I mean, again, I am going back to something I was trying to get at or understand a little better.

Mr. BOWSHER. Yes.

Senator KOHL. Why has this happened. Why is it, in spite of the fact that it is crystal clear to all of us who have brains—and we all do—that we have severe problems that have to be addressed in strong ways.

Mr. BOWSHER. Yes.

Senator KOHL. We have to make real tough decisions.

Mr. BOWSHER. That is right.

Senator KOHL. And this has been true for years and years. Why does it happen? Do you really think that this year is going to be the year that we face our problems?

Mr. BOWSHER. All right. Why it happened. And that is that in the early 1980's—well, let me go back, if I could, just for this point.

In 1974 and 1975 I did a balance sheet of the Federal Government, and the Federal Government was really in good shape in the middle 1970's. After all the wars—and we had just been through the Vietnam War at that time—the recessions, the depression, everything like that—we had a debt of over $400 billion, but we owed about $100 to $150 billion of that to the trust fund.

So our net debt was only about $300 billion. We were down to 18 percent of our GNP, having come down from over a 100 percent in World War II.

So as much as people worried about the size of Government in those days, and the size of our deficits, if you just took a snapshot as to where we stood, financially speaking, the Federal Government was really in good shape in the mid 1970's.

Now what happened was, in the early 1980's, why, with the tax cut—as Senator Levin pointed out—we initially, then, took a reduction in revenues, and the economic thinking that the Administration was following at the time was that the supply-side economics would generate increased revenues and that we would have lower rates, lower taxes on some things, but more revenues in total coming in.

Unfortunately we hit that recession in the early 1980's, and either supply-side economics did not work, or the recession nullified it.

The economists would debate that, but, the end result is that we quickly went into these very large deficits. We went into $150 and $200 billion deficits in I think 1985, and then everybody got very concerned, and that is when we passed Gramm-Rudman-Hollings in the fall of 1985, to begin in 1986.

So we were going to come down in an organized fashion, in 5 years, to a balanced budget. That was the Gramm-Rudman process.

Now, in the first year, we did do a sequester, and that is when we were in the decisionmaking role, and the sequester was limited. In other words, it could not be more than 11.7 billion because we were already into the fiscal year.

So that is what we did. But even with that, sequestering that cut, the budget deficit ballooned to an all-time record on a unified basis, including the trust funds, of $221 billion.

Now, the second year, they really cooked the books. In other words, they changed payrolls from one fiscal year to another. They declared that they were going to meet the targets, and everybody went home for the elections.

And then in the third year we changed the targets. We went from a target of $144 billion. We just moved it over one year, and even moreso, the following year in the new targets, was to come down only $8 billion. That was the year we are in right now, fiscal year 1989, and then the targets were going to be to come down 4 years in a row at $36 billion a year. So we are really going to get religion, but, see, the religion part was put into the next Administration. That is the Bush Administration. That is the 4 years, now, that we are all facing.

And so when everybody relies, as they do so much, on the fact that we have a Gramm-Rudman process, and we have a Gramm-Rudman plan to come down, now, in 1993 to a balanced budget, I am here to say do not get too enthusiastic about the fact that this is going to happen, because it did not happen the first 4 years under Gramm-Rudman.

And I am worried, that unless we make the tough decisions—as Mr. Lieberman was describing—on revenues and things like that, I do not think it is automatically going to happen, no matter what kind of an automated process we have there.

Senator KOHL. Thank you.

Mr. BOWSHER. And that is how we got into this fix in the 1980's.

Chairman GLENN. Talk about getting religion. The new President, Mr. Bush, is going to have a whole camp meeting to deal with this one.

Senator Pryor.

Senator PRYOR. Thank you, Mr. Chairman.

I would, once again, like to return, Mr. Bowsher, to the S&L situation. How long do we have—and this may have been previously discussed—but how long do we have to deal with this problem?

Mr. BOWSHER. Well, you know, I was in the private sector most of my life, and I was always surprised, sometimes, how some of my clients could last a very long time when I thought they were in deep financial trouble.

And now I feel the same about the Federal Government. In fact Paul Volcker, as I said earlier, was over having breakfast with us this morning, and he feels the same way.

When we started working on this problem a few years ago, we did not think you could go this far and not be in deep trouble, and the amazing thing to me on the S&L crisis is how fast it has mushroomed.

I can remember 2 or 3 years ago having a huge debate over here—and I think Senator Glenn can remember it, too—about how much to put in to solve the S&L problem.

And we were saying at that time $15 billion, and the Treasury was agreeing with us, so it was $15 billion, pretty much, what was proposed.

The industry rolled in here with all their high-priced lobbyists and said these guys are being too pessimistic. Five billion might be okay. They compromised at ten. Boy, let me tell you, that $10 billion did not even come close.

Looking back now, our $15 billion probably was not a high enough figure, and I also remember that some of the people from the Bank Board came over and said that the previous year you booked a $12 billion reserve adjustment on the insurance fund. We think you were too pessimistic; if you want to reverse that this year, why, we will work with you.

And I said, look, we are going to go right down, just the way we did that reserve last year, bank by bank, S&L by S&L, and figure out what has to be in the reserve with your people, and that is what we will book at the end of the year, just like we do any normal financial audit, and when we did that, of course it was bigger.

And now what Mr. Wolf announced out in San Francisco 2 days ago is when we lay the current settlements and the current operations of the FSLIC against what our reserves were just one year ago, we see that these bailouts are costing twice the loss that was projected in our reserve last year.

So, what you have is some 500 institutions that are under water still able to attract deposits, though there was some limitation put on this this past year, and the losses are mounting very, very fast.

Senator PRYOR. Do we see an increase in liabilities, say, each month that we postpone resolving the problem?

Mr. BOWSHER. Yes. That is exactly right. Every month that many of these stay open, the liability is increasing; the loss is increasing.

Mr. FOGEL. So we think, Senator Pryor, that the quicker the Government can reach resolution on what to do with these bankrupt S&Ls, the better off everyone is going to be in terms of the financial liabilities.

Chairman GLENN. David, will you yield just for a second.

Senator PRYOR. Yes, Mr. Chairman.

Chairman GLENN. Is the figure that has been bandied about of $1 billion a month, is that realistic as the increase of how we are getting on into trouble?

Mr. BOWSHER. That is not too far off. That is in the ball park, we think.

Mr. FOGEL. What we have got to do is fairly quickly figure out what it is going to cost to basically deal with these—we want to call them the bankrupt S&Ls—and we have got to find the money fairly quickly to put it up so we can get this behind us.

The longer we delay, the more it is going to cost in the long-term.

Mr. Bowsher. And one of the problems with the deals that were done in December, is that they were all done with notes and guarantees, because the insurance fund does not have any money. That gets you right back to the chart over here, that this is going to be one of the big items that has to come into the budget process very quickly.

Senator Pryor. Of the 500 bankrupt or insolvent S&Ls, what percentage of those bankruptcies are directly attributable to mismanagement of the officers and/or directors of those S&Ls?

Mr. Bowsher. We do not have a percentage of the total, but what we do know now, having looked at quite a few of them, is that it is a much higher percentage than you would have anticipated, or we would have anticipated. As I said earlier, we have looked at 20-some or so institutions which were identified for us by the staff of the Banking Committee. We are going to be issuing a report on this, and practically in every one of these cases there was either mismanagement, fraud, or inside dealing.

Mr. Fogel. We believe there was a lot of mismanagement. There was absolute fraud in a fair number of cases.

Senator Pryor. Of those 500 institutions that are insolvent or bankrupt, how many of those institutions are still doing what the S&Ls were chartered to do, and that is, to make home loans?

How many of those are making home loans today?

Mr. Bowsher. I cannot give you an exact percentage, but one of the big problems is many of them moved out of that traditional business, and started to make different loans, and speculative loans.

Senator Pryor. Is this when they got in trouble?

Mr. Bowsher. And this is when they got in trouble lots of times.

Senator Pryor. All right.

Mr. Bowsher. A lot of people will say that, well, you know, this is a problem because of the economy in Texas and Oklahoma. But, if you look at California, which has had a really strong economy for this decade, you have a large number of large S&Ls in deep trouble, and they are a big part of the five hundred.

And so it is in many of those where we see the mismanagement, and the changing of the line of business, literally.

Senator Pryor. Mr. Chairman, my time has expired. May I ask two quick questions?

Chairman Glenn. Sure.

Senator Pryor. I will make these very quick.

The S&Ls today, many of which are insolvent, are continuing to pay even a higher rate of interest to the depositor, therefore threatening the ultimate liquidity of the institutional banks.

In addition to this I know of some—in fact I know of some in my home State, and I will probably get in trouble with them—that are paying their presidents and some of their officers $300,000 and $400,000 a year. How does this occur? What are we doing about this?

Mr. Bowsher. Well, see, as Mr. Fogel pointed out, until you can move in and really take control, and shut them down, much of this can continue. In other words, you have a situation where until the Federal Government acts, it is going to continue.

I remember watching MacNeil/Lehrer recently. They had the president of one of these really defunct banks. This was a bank where 96 percent of the loans were nonperforming when the Federal Government finally moved in.

They said to the president of that bank: did you have any trouble attracting deposits? And he said no, not at all. He said all we needed to do was pay a little more in interest rate—which is the very thing that you identify—and to have that sticker on the front window that the deposits are insured by the Federal Government.

And the confidence stayed up, and that has been true, I think, in this industry.

Mr. FOGEL. What you have to do, Senator, is close those institutions down as quickly as you can, while protecting the people who have money in there. But it is a Catch-22. To stay open they want to pay more interest, and they keep bringing in more funds that the Government then has to insure, and they are bankrupt.

Senator PRYOR. The Chairman is going to put the clamps on me in a moment, so one quick, final question. The Corps of Engineers has a formula for deciding whether or not to fund a project, and that is called the cost-benefit ratio.

What is the cost-benefit ratio of asking the taxpayers of this country to fork up, say, $100 billion to bail out the S&Ls?

Is the benefit going to justify the cost?

Mr. BOWSHER. Well, the downside, the risk if you do not do an orderly bailout here, is the confidence that you are going to have in your banking system.

In other words, there are depositors. We are not talking about here—at least not until we got to these December deals, as I refer to them—but what we are trying, and I think what we should be trying to do is protect the depositors, not the stockholders, not the management of these banks that are under water.

But if you do not protect the depositors, especially up to the $100,000, then what you could run into is the crisis of confidence, and bank runs. So, that is the dilemma that you are in.

Senator PRYOR. Thank you, Mr. Bowsher. I apologize, Mr. Chairman.

Chairman GLENN. No. That is fine. And you start a run on the banks and then you are in deep trouble.

Mr. BOWSHER. You are really in deep trouble.

Chairman GLENN. In deep trouble.

Mr. BOWSHER. In fact one of the amazing things of this whole process, I think, is the way the confidence of the American people has held up with all these problems being laid out practically nightly now on the television news.

Chairman GLENN. I do not want to be Pollyanna, but is there any chance at all we could grow our way back out of this thing?

This problem started in the Southwest. They were oil patch problems, as have been talked about. I was reading an article last night in one of the financial magazines—whichever one it was—about the fact that Texas is now recovering. It is coming back, and that means that the property values, the loans are probably not going to be quite as risky as they were.

Is there a chance that that can help us out of this any?

Mr. **Bowsher**. That has always been the hope out there in the depressed areas—Louisiana, Texas, Oklahoma, and it has not happened so far. If it does happen, if the economies come back, then it would mitigate some of the problems that we are looking at.

Chairman **Glenn**. Senator Roth could not be here this morning, but a member of his staff gave me this question to ask on his behalf, so I will do that right now.

Should the S&L bailout be on or off budget, and what are the implications of the integrity of the budget process, if it is off budget? Should it be on, or off budget?

Mr. **Bowsher**. I think it should be on budget, unless we go eventually to some kind of a restructured budget where we have those different breakouts, and then I think that the categories ought to be more along the lines we illustrate.

But I think if we do not change the structure of the budget, then I think it makes sense to keep it on budget, and we are just fooling ourselves if we do not, because we are going to have to borrow the money. It does not really change the real economics.

Mr. **Fogel**. If it is off budget, and we have to borrow, we end up paying more in interest than if put it on budget.

Chairman **Glenn**. I would think so, too. If you are going to take your debts off budget, then there are some other pluses we have got to take off budget, too, like the trust funds, if you are going to be honest about our budgeting process.

Mr. **Bowsher**. That is right. Yes.

Chairman **Glenn**. You stated in your testimony a revenue increase through some type of tax scheme is all but unavoidable.

You mentioned that using a mix of tax instruments is likely to be more appealing than relying on one type of tax.

Can you tell us what mix of taxes you believe should be implemented, or would be the least unattractive at this point?

Mr. **Bowsher**. Yes. We did not select any one, or two or three, but what we did in our third report in the 26 series is to come up with what we call revenue options. I think that if the gasoline tax generally is considered—for every one cent increase you have, you raise a billion dollars.

I think if you were to change the rates slightly, which is not easy to do because of the compact that the Government made with the taxpayers in the Tax Reform Act, but if you have to go to a rate increase, why, if you were to raise, say, the 15 percent to 16 percent, and the 28 to 30 percent or something like that, you could raise about $30 billion.

If you go to the VAT taxes, why, a 5 percent VAT tax, if you exempt food, housing and medical, you would raise about $60 to $70 billion.

If you go to this—and what a lot of people refer to as the sin taxes—the cigarettes, the alcohol and that—we think that is something that should be considered, along with reviewing the excise taxes, of which many have not been reviewed for many, many years.

So we think those are the basic options, and as you point out, Mr. Chairman, one of the things we think ought to be looked at is some combination.

In other words, it might not be feasible to do it all with one big change, but maybe some combination of those kind of efforts might give you some revenue.

Chairman **Glenn**. During the presidential campaign, it was proposed that if we just had better collection, of course, it was going to be a gain for us—what was it, $60 or $70 billion a year, something like that?

I had thought that we were on a very false economic basis when we cut IRS agents as a way of saving money, because I think the rough rule of thumb we have used in the past is that each IRS agent collects his keep 5 times over.

Now obviously you cannot just say we put on 10,000 agents all of a sudden and have a balanced budget.

But how much do you think we can realistically raise out of those taxes that do not get paid? I think you estimated the taxpayers will fail to pay more than $87 billion owed in 1988. This amount could exceed $100 billion by 1992. That is a lot of bucks.

What do you think we can do in that regard, and what is realistic to expect us to pick up, if we put more IRS agents on, and really went after that money?

Mr. **Bowsher**. Yes. We think you could pick up several billions of dollars with better administration.

Chairman **Glenn**. Like several, or several tens, or———

Mr. **Bowsher**. We are not really sure. We are really not sure about that. We think the better administration, which includes not only additional agents, but maybe also improved systems.

In other words, I think one of the big things today that gives you the voluntary compliance is the sense that the IRS systems of matching are working well, and that the audits, although done on a random basis, are liable to catch anybody that is not paying the right amount of taxes.

Unfortunately, the percentage of audits every year has been going down steadily. In fact they are struggling right now to stay above 1 percent. At one time I think that the audit rate was 4 percent.

I think also the systems. One of the things that worries me a great deal about the IRS is the state of their systems, as I mentioned earlier.

If you ever visit one of the IRS service centers you would see a 1950 technology of computer systems. If somebody files in any area of our country and their return goes to that service center, and they are going to get a refund the system works something like this.

After being put into the basic system at the service center, literally, that magnetic tape, which is 1950 technology in computers, gets transported down to West Virginia where it is put into the central system.

If a check has to be cut for a refund, they have to transport another tape up to some regional finance center in the Treasury system and issue that check.

That is technology that no private firm today would use, and I just think if there is one area that we ought to invest in, it is the IRS systems to make sure that we are tracking the money properly and doing the proper matches so that we maintain what I think is one of the great strengths of this country and the Government, and that is a voluntary tax compliance system that has worked very well over the years, but which I think is on thin ice now.

The other thing in our management review on the IRS, which we issued this past year, is the difficulty that they are having with acquiring people. This is a very large organization.

They have to hire lawyers, accountants, and computer specialists, and at the current salaries, and the working conditions there, they are not getting very many people from the top third of the class.

In fact a lot of the people are in the bottom third. And so you do that over too many years, and you have an organization of how many, Dick, a 100,000?

Mr. **Fogel**. Over a 100,000.

Mr. **Bowsher**. Over 100,000 people. Pretty soon you have an organization that is just not first rate.

Mr. **Fogel**. Senator Glenn, in addition to the tax gap, I think one area where IRS can do a lot better job is in collecting what is already on the books.

They have $56 billion in accounts receivable at the IRS right now. Now, internal IRS studies estimate that over time—and you are talking about not in 1 or 2 years, maybe over a 4- or 5-year period—you might be able to collect maybe $25- to $30-billion of that.

That is already money that the taxpayers owe, that they are not collecting and not doing a good job on.

Chairman **Glenn**. Do they just not have the people to follow up, or is there just not the will to do it?

Mr. **Fogel**. Well, they have not managed part of it properly. They have not given it as much attention as they should have over the years. As Mr. Bowsher says, they do not have some of the proper assistance.

But, you know, there is money to be received there. But one of the things we do believe fairly strongly is that you cannot look to really dealing with the deficit problem in any significant way, in a short number of years, by improving IRS's administration.

IRS's administration must be improved. They must do more audits than they are doing. They must collect more taxes that are owed. But that is not going to help you get out of the Gramm-Rudman dilemma.

Chairman **Glenn**. Yes. I read somewhere where they ran a survey, they had sample problems that they sent to various IRS centers, and there was a huge number of different answers. In other words, the people problem is a major problem.

Mr. **Bowsher**. It is a major problem.

Chairman **Glenn**. It was like 30-some percent of the answers they got back were erroneous.

Mr. **Fogel**. Well, we issued a report on that last year.

Chairman **Glenn**. Maybe it was your report that I read.

Mr. **Fogel**. It really is a problem. Again, it has to do with the systems they have. If you have got a minute, the poor person down there at IRS at the service center gets a letter from a taxpayer, and he or she is looking at a computer screen, and then says, well, I think I need to pick paragraph 22 and paragraph 48, and paragraph 170 to answer this letter.

The way the system works, that person never even sees those paragraphs together in the letter, and that person somehow pushes a button, and then it goes over to—somewhere else, and the letter is printed out.

So it is no surprise that some of these letters are not intelligible to anyone, probably not even the poor person who is trying to select the paragraphs to put together.

I know Senator Pryor has done a lot of work looking into this.

Chairman Glenn. It sounds like some of our mail rooms on Capitol Hill. Senator Lieberman.

Senator Lieberman. Mr. Chairman, if I may, talking with Senator Kohl here, I have a good news, bad news feeling about this hearing.

There are a lot of problems, obviously, but I think Senator Kohl and I, in some sense, are grateful that you did not solve all the problems before we got here. It leaves us some work to do.

Mr. Bowsher, your chart on unfunded, unavoidable costs has a question mark for Department of Defense weapons cost overruns. I wonder if you have any ball-park estimate of how much that might come to?

Mr. Bowsher. We do not because we do not have the information, but that is one of the things—if you remember—I said that I thought the Secretary of Treasury and Director of OMB ought to ask the new Secretary of Defense to come up with.

Now what we do know is—and I would ask Frank Conahan, here, on my left, to add to my description here—that the Navy shipbuilding program is getting into trouble again.

In other words, we had a lot of trouble with that in the early 1970's, after the fixed-price contracts in the early 1960's were not able to—in other words, the shipyards were not able to build the ships for the amount that the contract called for, and we got into this claims period.

We have a lot of indications now, in the work that GAO is doing at the major shipyards, that we are getting back into that same problem, and that is we went to fixed-price contracts here, and a fair number—how many is it, Frank?

Mr. Conahan. There are 26 contracts right now for about 75 ships. Twenty-one of those contracts are overrunning to the tune of over $2 billion.

It increases on a monthly bases. Claims have been submitted and paid for some of the earlier contracts, and claims are being prepared now for some of the current contracts. So it is an increasing problem that we will see a lot.

Mr. Bowsher. Yes. And then we also know that we had major problems in the two big bomber programs, the B1 bomber, and now the Stealth bomber. We are not aware of the technical problems yet in the Stealth bomber, but if it is going to have to be stretched and not brought out on schedule, we know that that is going to run up some big sums of money, too.

Senator Lieberman. So those three areas are——

Mr. Bowsher. We know that those three areas are in trouble, and we also know, like the AMRAAM, and a couple of others.

Mr. **Conahan**. The sophisticated missile systems are overruning in large measure. The AMRAAM has almost doubled in unit cost.

Mr. **Bowsher**. Yes.

Senator **Lieberman**. Is there any procedure by which OMB has timely information about possible cost overruns in DOD weapons systems?

Mr. **Bowsher**. If they get the SAR reports and manage from those, that would give them some indication of what the cost overruns are. I am not sure whether they do that, or not.

Senator **Lieberman**. I have a little more time. If I may go to another subject area, very briefly. Environment is a real concern of mine, and I was interested in the comments in your statement, and in the longer statement that I saw earlier, where you quite correctly point out that the function of the Environmental Protection Agency is somewhat different from other agencies, which is to say that it does not directly carry out a mission. It makes sure that other people, either private sector or public sector people are following the laws.

So that the upgrading of its efficiency may not only have to do with more money for more staff, but with better management systems to oversee public or private sector entities.

What might those systems be? What do your studies lead you to conclude about how EPA, for instance, could improve its ability to carry out its function?

Mr. **Bowsher**. We did a management review of EPA this year, and Dexter Peach headed that up, and so I will ask him to answer the question.

And what I would like to do, too, Senator. is send you a copy of that report.[6]

Senator **Lieberman**. I would appreciate it. Thank you.

Mr. **Peach**. One of the things that is happening, Senator, is that we are coming up with new environmental problems. They may be radon, they may be global warming, to add to the environmental problems we already have.

They manage, and we, through legislation—and EPA manages most of it on a media by media basis—air programs, water programs, and so on. And we look at the budgeting and the operations of the agency in that sort of fashion.

EPA really does not do a good job, although they have been trying to make some efforts in the agency to really look at priorities, and to look at environmental results.

What do we want to get in the way of environmental results in areas? What are our highest priority areas right now? And then begin to link that into their planning and budget systems within the agencies.

Their planning and budgeting systems are not even in sync with such efforts as they have had, to try to understand what the highest priority items are.

If you look at what the plans are for what they are saying they are going to do, and then look at where their money is budgeting, it is out of sync with those priorities.

So we are saying we really need to look at a system that enables us to look across media better, that enables us to understand our highest priorities, and have the planning and budgeting systems that cycle with those kind of priorities, and then have the kind of information and feedback systems that help you understand what kind of results you are getting to move against those priorities.

---

[6] "Environmental Protection Agency: Protecting Human Health and the Environment Through Improved Management," August 1988, U.S. General Accounting Office.

Those kind of systems do not exist at EPA now, and one of the problems is, though, from that agency's standpoint, is the size of the responsibilities we have laid on that agency, the number of environmental problems and the challenges they have in front of them.

Senator LIEBERMAN. So what you are saying is that there is no way within the current staffing that they are going to be able to carry out all of the responsibilities that Congress has given them. So they are going to have to prioritize.

And what you are saying is that the money is not—well, where is most of the money going?

Mr. PEACH. Well, historically, a lot of the money of course has been going to water. We increasingly are seeing more money going to hazardous waste, but it is clear to most people, that the amount of money that we are putting into hazardous waste is not going to be enough to deal with the problems in that area.

And then we are beginning to add new problems on top of it, when we talk about radon, global warming, or other things.

So there is going to be a question of priority setting, and then trying to understand how we can make progress against the things that we place the highest priorities on, in trying to bring our budget amounts in line with that.

And this is just not the way that we have done business, historically, in that area, but we think it something that both the Congress and the Administration need to look at in terms of how we view environmental programs.

Senator LIEBERMAN. I take it you reached a judgment that this is doable. In other words, it is possible to establish performance standards, or result-oriented goals in this area?

Mr. PEACH. We think it is possible. We think it will take some work on the part of EPA, but we try to lay out in our management review examples of the kinds of results-oriented standards that you could set in areas, and how they might work to be coordinated with the planning and budgeting system.

Senator LIEBERMAN. Thank you.

Mr. PEACH. I met with someone who has been working—a former deputy administrator of EPA by the name of Al Omm, where EPA has extended a contract to a firm he now works with, to try to help work on a system that would bring their planning and budgeting systems into sync with a system to try to establish priorities.

So the agency has been responsive and receptive to the suggestions we have made. We will have to see how that goes, now, as they bring in a new team.

Of course Mr. Thomas and his team will be leaving and we hope to be talking with the members of the new team there.

Senator LIEBERMAN. Thank you.

Chairman GLENN. Mr. Kohl.

Senator KOHL. It would be very helpful for me, tomorrow, to know from each of you what question you would most like to have me ask, or the concern that you would most like to have me express to Mr. Darman with respect to this new Administration and budgeting.

I would be curious to know what each of you feel about that. Just a simple question, or a concern that you have. The most important one.

Mr. BOWSHER. Yes. All right. I will lead off and let the other people think about it for a minute.

I would have two questions. One would be how are you going to work with the Congress in achieving some kind of a multi-year approach to bringing down the budget deficit, and are you willing to put the major issues back on the table?

That would be my first question. The second question would be: how are you going to organize OMB and get it so that it can really be on top of the problems as they start to emerge, so that we do not have some of these situations mushroom on us in the years ahead.

In other words, somebody said it earlier: the management part has never really been working very well over at OMB. The budget part has been the historic role over there, and the integration of management or program oversight—as I often refer to it—to me, has never gotten quite the same emphasis.

And I think another question would be: how do you plan to either organize or manage OMB to get more of the big picture of what is happening in the Government, rather than just handling the budget numbers, you might say.

One thing I want to say is that I feel very sorry for a lot of people over at OMB I am not trying to be critical here today—because they have come down in size in dramatic fashion and you have added complexity to the budget process.

One of the problems with the budget is that we have always had two processes—authorizing and appropriating—and then in 1974 we added the congressional budget process, took away nothing, and then we added Gramm-Rudman.

So we have four processes that turn the budget into a 12-month operating system that everybody—and I am afraid you will learn this, Senator Kohl—has a very difficult time coping with.

And I think some day one of the things that has to be done is to streamline all these systems back to something that is more realistic as far as process going, and if you wanted to ask a fourth question, I would just ask about how do we streamline the budget process? Do you have any ideas on that?

Senator KOHL. Thank you. Frank?

Mr. CONAHAN. I think it might be instructive to reflect for a moment on the defense budget of just a few years ago.

The Congress mandated the Department of Defense to come up with a biennial budget for fiscal years 1988 and 1989.

That budget was submitted in a January-February time frame of 1987, at which time it should have been evident to the Administration and the Secretary of Defense, that it was not going to be able to sustain the projections that it was making and had been making in the previous 6 or 7 years.

The first year of the fiscal year 1988-1989 budget, while over what I think was realistic, was not too bad in that sense. But the second year of that fiscal year 1988-1989 budget was way beyond anything that I think anybody in this town could realistically expect to come out of that budget go-around.

The Congress, on several occasions, asked the Secretary of Defense to rescrub that budget. He refused to do so.

At no time would he provide the information to the Hill which was necessary in order to have a favorable outcome on the 1989 portion of the 1988-1989 budget.

I might add also, that there were panels here on the Hill that were not fully brought into that process. I guess I would ask the new budget director tomorrow, if we, up here on the Hill, after scrubbing the budget, find that some adjustments, modifications need to be made, that we need new insights into what some of this program means, that you have got into the budget. Will you work with us, so that we can, together, make some long-range sense on solving some of the problems that Mr. Bowsher has been talking about here?

I think that that has been absent here in past years, and I think it is crucial to do some of the things that we think need to be done.

Senator KOHL. Thank you.

Mr. FOGEL. I would ask two questions. The first one would be along the lines that Senator Pryor asked us: how quickly does he believe the S&L crisis needs to be solved and is he willing to commit to a long-term financial plan to get us there?

The second one goes back to something that you said earlier, Senator Kohl, about the people issue, and, you know, all these programs are run by people, and we all ought to be accountable for something.

I think it would be instructive to ask him what he sees his relationship to be with the Cabinet Secretaries and the President in terms of agreeing on several key policy and programmatic issues, and how they tend to hold themselves accountable for tracking those things, and saying whether they are achieving their goals.

In the past there has been, historically, for over a decade, not enough attention paid to what are a couple key issues that we—by we, I mean the OMB, agencies, the Congress—what are we really trying to solve? How we want to hold ourselves accountable; how we want to track our progress.

OMB ought to play a key role in that. It gets back to what Mr. Bowsher said, and that is management of the Government. It is not dealing with little management issues. It is dealing with fundamental management to improve the service delivery of the Government.

They have not played as good a role as they can. I think it would be instructive to try to draw him out on his role in that regard.

Senator KOHL. Thank you.

Mr. PEACH. To return to a topic that has been a favorite of Senator Glenn's, that we have been involved with often over the last couple of years—the Department of Energy's defense nuclear complex, and I look forward to the opportunity to testify before this Committee next week, in more depth about some of those problems.

But that has been identified as one of the major long-term problems now facing the new Administration. The Department of Energy has recently come forward with a report which we understand has gone through OMB's review regarding what they plan to do over the next 20 years.

They talk in that report in terms of a cost of $81 million to be spent, that is split out between $52 million, approximately, for modernization and upgrading, and $29 million for environmental clean-up, restoration type of activities.

That environmental clean-up figure appears to be a level of effort of funding of what they expect to spend next year, annualized for the next 20 years.

Without any idea of what the total scope of the problem is that you are trying to address, and the efforts that are going to be necessary to deal with the problem, how open are you to looking at that area in terms of increases in funds, as the total scope of the problem is defined, and we learn more about what it is we need to do?

Senator KOHL. Thank you.

Chairman GLENN. Thank you very much, and that 29, incidentally, is for current ES&H as well as clean-up, which means that we do not even come close, on clean-up, to what their estimates were.

Mr. PEACH. Yes. My sense, just looking at it quickly, it looks like they added about $150 million in annual outlay expenditures to what they were already spending for 1990.

Chairman GLENN. Senator Pryor.

Senator PRYOR. Senator Kohl has posed such a brilliant question, and he now has four questions ready for the hearing tomorrow. If you have any additional ones, Senator, just call me up this afternoon and say, here's a couple more that we want to have asked.

I think that was a very interesting line of questioning. You do not have to have staff people. You can use these folks to help prepare questions for future witnesses.

Mr. Chairman, on February 3, my Subcommittee on Federal Services, Post Office, and Civil Service will hold a hearing on an agency alluded to earlier—the Environmental Protection Agency (EPA). We are going to look into EPA's background a little bit and will focus on one of my favorite subjects: consultants and contracting out.

For example, 85 percent of the Superfund money administered by EPA is contracted out. Perhaps 90 percent. But something along that line.

I think we need to know why. I think we need to know where these dollars are going, what results we have gained from the expenditure of these dollars, and how these contracts were awarded.

Is it the old buddy system that we see across the river in the Pentagon, cronyism, or whatever? We are going to look at EPA, and then we think we will see a mirror, basically, of the Federal usage of consultants.

So we invite anyone from your operation to be present for that particular hearing on February 3rd.

Mr. FOGEL. Well, we are scheduled to testify, Senator, and look forward to that.

Senator PRYOR. Good. And I look forward to your comments on that particular day.

The second thing relates to the budget process. It has been alluded to earlier Mr. Chairman, so I will bring it up again.

What was wrong, Mr. Bowsher—I am old-fashioned—but what was wrong with the system that served us pretty well for 200 years? I refer, of course, to the old system prior to 1974, which was the authorization and appropriation of funds. What was wrong with that?

And I was not here in 1974 when the Budget Act was adopted.

Mr. BOWSHER. Well, there was a feeling at the time that you had two or three problems.

One was that there was not an overall congressional effort at the beginning of the year to set targets, you might say, that then the Authorizing and Appropriation Committees would come within, and that they really did not know, until you got through that process, as to where things stood.

Now I think what happened, though, during those years—because when I served at the Pentagon I worked with the process for 4 years, and was the head of the Navy budget—I think the leadership, lots of times, got together in an informal way, and had some idea of where they wanted to come out in that.

So I do not think it was out of control as much as maybe there was some indication.

Second, you did not really have good scorekeeping over here in the Congress, and I think CBO has done a really fine job in providing the Congress and the Senate with information on where do you stand on the budget as it goes through the process and what are some of the issues?

Now I think one of the problems that has been identified in the last couple years, that should be worked on, is unfortunately you get different scorekeeping now between OMB and CBO, and that confuses it.

And so I see in Senator Domenici's ideas, that he has put forth, and I know Mr. Miller, who was the head of OMB, they were very anxious to try to pull it into a scorekeeping function that everyone can agree on.

You know, some of these are very technical issues, but I think it would be very helpful if we did not have this different scorekeeping. So I think the scorekeeping that CBO does has been very helpful to know where things stand.

I truly think the overall front end of that budget process, of the congressional budget process, might well be looked at as whether you need all those resolutions, and the separate Committees, and everything like that.

Because as I say, when you put it in there in 1974, you did not take anything out, and another thing that I think is a problem, is when you ask elected officials to vote on the same issues too often, and when they find that it does not solve the problem in the budget, that gets very discouraging.

And so there is a great tendency then not to make the decision, to let it push out.

I found that out at the Pentagon when I went there in 1967. As much as the vaunted TPVS system was so highly touted under Mr. McNamara, it never really worked on schedule.

In other words, they ran into the same problems at the Pentagon that you have run into here with the Congressional budget process.

And so I think if you are going to look at the process and try to streamline, which I highly recommend, I would sure look at all those decisions that you have got built into the front end of it, to see whether you needed them all or not.

Senator **Pryor**. Frankly, I would like to go back to the old system. I think it served us better. It may have been a little bit inefficient, but I do not think it was as inefficient or as masking of the real problems that we face as is the present 1974 Budget Act. But that is my personal opinion, and I may be in a minority of one on that. Thank you, Mr. Chairman.

Chairman **Glenn**. Or perhaps go to scorekeeping which is—that was a real gap, as I understand it.

Mr. **Bowsher**. Yes.

Chairman **Glenn**. This whole thing went into effect just the year I got here. I was sworn in in January 1975. You may want to do some of that, or combine some of the authorizing process with CBO. I do not know. There are all sorts of permutations you could make on that one.

I would like to wind this down in a few minutes here, and close the hearing, and I would like to limit our next round here to one question, or if anybody has a burning desire for more than that, why, so state. But I would like to wind down here as soon as we can.

I will ask just one more myself, and that is, on the trust funds, which you started out talking about here, are a huge balancer of the budget.

Now those are supposed to be set aside for a particular purpose. They are supposed to be earmarked funds yet we use them here to balance. Now you cannot just take them out—or maybe you can take them out. I do not know. I guess that would be my question.

Would you favor taking most of these trust funds off budget again? And I will say, when we put them in—some of that happened before I got here, too—but putting trust funds in budget, so that the taxpayers knew what their total cost to Government was was the idea.

But they have been so misused now, that we cannot upgrade the airway system because they do not want to show a bottom line on the budget, and so we are going to start having aircraft accidents one of these days because we will not upgrade our air system, even though you pay an 8 percent tax on every airline ticket to do exactly that.

And we have what, $7 billion in the Airway Trust Fund now?

Mr. **Bowsher**. Something like that. Six or $7 billion.

Chairman **Glenn**. Anyway, you can go on and on with examples like that, where we do not use these funds for what they are supposed to be used for.

Should we take them off budget? Would you recommend that so we have a more clear budget picture, a real budget picture of what the situation is?

Mr. **Bowsher**. Yes. No, my preference would be to keep everything on budget, but to have the different categories, and then to have your targets, whether it be the Gramm-Rudman process or some new multi-year Gramm-Rudman modified approach—key into those various numbers there so that you are getting to where you want to be on the general operations of Government, on the trust funds which you are trying to build up reserves, and on your enterprise.

And I would also have some kind of a split between operating and capital, and I would sure have management reporting on those capital projects.

In other words, in addition to the major defense weapons, you have got these big programs at the FAA, where we have now the largest civilian project, the NESS system, since the Apollo project, and we ought to have adequate reporting on where does that stand each year so Congress knows, and OMB knows.

And I think you could take some kind of a structure like this and really tie your management systems in to knowing where things stand, and still have the benefit of the unified budget so that you could see what originally was intended, what is the total operation here.

But as long as you use the total column to be the Gramm-Rudman targets, then you force yourself into the decisions that you describe on the Highway Trust Fund, and the Aviation Trust Fund, and that. You are mixing apples and oranges—that is what you are doing—and it is leading to bad decisionmaking.

Chairman GLENN. Thank you.

Mr. PEACH. Senator, I would just add: you brought up the Aviation Trust Fund, and there is an interesting phenomenon occurring there. Let's vote for this NESS plan, this big modernization plan. It also includes airport and airways grants, and it also includes some funding for operations and maintenance—personnel costs, controllers, and other things like that.

Only a small amount, about 40 percent of it, is going for this NESS plan right now, and almost all the trust fund money is going to be needed for the NESS plan if they meet the total $25 billion cost we are talking about through the year 2000.

But they are proposing, in this year's budget, to use an increasing amount for regular operations and maintenance costs.

So you are finding a greater amount of trust fund, it looks like, beginning to go into the operations and maintenance expenditure area.

And if they are going to use the trust fund for that area, you are going to have to increase the money coming into the trust fund or either you are going to have to find some general revenues from other sources to fund some of these FAA operations.

Chairman GLENN. You cannot ignore one at the expense of the other, though. You cannot say that we should not have maintenance funds in there because pretty soon you will have a very modern system in the air, as far as controlling goes, and no airports to land at, to carry it to the extreme.

Mr. PEACH. Well you have got no airports to land at, and one of the other things we pointed to is they are running a real shortage, looking into the future, of maintenance technicians. They are going to have all this fancy sophisticated equipment but who is going to maintain it for them.

Chairman GLENN. Senator Kohl.

Senator KOHL. No, thank you, sir.

Chairman **Glenn**. No more? Thank you. I hope you will respond, as usual, to additional questions that we may submit to you from other members. It has been very, very interesting this morning, as usual.

We wish we had a 20-hour period to go into these things here. The transition reports you put out, I think are very good. I have not gone through all of them, I have gone through some of them, but I want to congratulate you on those, and we always look forward to your testimony here because we always get into these very interesting discussions.

We appreciate your being here this morning and I think we have Mr. Peach coming back here to testify—I do not know whether Mr. Peach, you are due back with us on the 25th or 26th when we go into some of the nuclear matters, but we do look forward to that.

The hearing will stand in recess, subject to the call of the Chair.

[Whereupon, at 11:57 a.m., the Committee was adjourned, subject to the call of the Chair.]

APPENDIX

United States General Accounting Office

GAO

Testimony

For Release
on Delivery
Expected at
9:30 a.m.
Wednesday
January 18, 1989

Transition Issues: Critical Issues and Problems Facing the New Administration and Congress

Statement of
Charles A. Bowsher
Comptroller General

Before the
Committee on Governmental Affairs
United States Senate

GAO/T-GGD-89-2

We are pleased to appear before the Committee to offer our views on critical issues the Congress and new administration must deal with if government is to function well.

Our message is not too optimistic. I wish I could tell you that the problems we face in our government operations are small and easily solved. The truth is that our problems are major, they are growing and they will not be easily or quickly dealt with.

The essence of federal management is policy implementation and delivery of program services. And a failure to invest sufficiently in key operations of government leads to a number of unpleasant consequences. First, it undercuts our ability to offer the American people the one thing they have every right to expect--a government that works well in providing services. Second, because government operations affect our dealings with other nations--in areas of trade, diplomacy, law enforcement, defense and others--such a failure has international ramifications. Third, because government operations are linked with the smooth functioning of the private sector the nation's business community is inevitably affected when we fail to invest in the central operations of government.

Unfortunately, GAO's work over the past decade has shown too often that we have not invested wisely in key government operations. The budget deficit and our reluctance to deal effectively with it have resulted in too many short-sighted decisions.

We summarized many of the areas we believe have to be addressed in our 26 transition series reports issued in November to the Congress and incoming administration. These reports were based on work we have done over the past decade examining major issues and problems in the executive departments and agencies. Our purpose in doing the transition series was to succinctly summarize the major issues in a readable fashion. We wanted to facilitate the ability of the Congress and the new administration to focus on key issues needed to improve the functioning of the government. Attachment I of my statement lists the 26 reports.

To help the Committee identify specific topics addressed in the reports and better appreciate the broad scope of this effort, I am submitting for the record a paper that outlines the more than 100 issues and problems addressed in all of the 26 transition reports.

THE BUDGET DEFICIT

Unless the deficit is solved--including finding ways to finance the growing list of unavoidable, but so far unfunded, costs--it will hamstring our ability to achieve other vital policy goals. There are no quick or painless solutions to the budget problem.

And to compound the difficulty, the budget problem is substantially worse than appears on the surface.

The reported deficit understates the real situation. In 1988, for example, the reported deficit of $155 billion actually consisted of a surplus of $97 billion in the trust funds and a deficit in the general funds of $252 billion. In addition, there is an explosion of unfunded costs, much of which are unavoidable. For example:

-- We estimate that it will take at least $85 billion more to solve the savings and loan crisis. Much of that money will have to come from the taxpayers.

-- We estimate that it will take from about $100 billion to $150 bilion to enable the Energy Department to clean up and modernize our aging and environmentally hazardous nuclear weapons production complex.

-- Several agencies are undertaking badly need modernization of key computer and telecommunications systems, involving substantial capital investment and operating costs. To give Americans the service they expect, we must successfully design and install modern systems such as those at IRS, social security, and FAA.

Even though DOD will likely have to live with constrained budgets, each of the military services says it needs billions of dollars more to complete its modernization and expansion programs. Major weapon systems are experiencing cost overruns and technical problems which will have to be funded and solved.

The budget problem requires a carefully developed, politically sustainable, multiyear budget strategy. All parts of the budget should be negotiable. The goal should be to reduce the deficits in the general fund and to move toward approximate balance or surplus in the unified budget at a steady, sustainable pace. The negotiations must work with realistic estimates of costs -- including recognition of known budget threats -- and with credible economic forecasts. Additional revenues are probably an unavoidable part of any realistic strategy for reducing the deficit.

KEY GOVERNMENT OPERATIONS

The examples of unavoidable, unfunded costs I just noted illustrate how we are falling behind in the investment needed to keep the most basic of our government programs on track. They are broadly representative of the strains now being placed upon key federal programs, largely as a result of the deficit.

When I talk about investment in systems and people I am speaking broadly. Systems means more than computers; it also takes in such considerations as management structure and regulatory administration. It includes all those things that are essential to the successful operation of any program or organization. Similarly, investment in people means more than hiring workers or paying them higher salaries; it means fostering strong leadership, high morale, and a commitment to excellence and service.

Let me take several program areas and discuss some of the fallout from the deficit and the disinvestment in people and management systems that has occurred.

The Savings and Loan Crisis

Reform of our financial institutions in the wake of the 1929 stock market crash and the Great Depression was a major achievement.

By and large, the reforms of the 1930s served us well for many decades, providing stability, protecting consumers, and fostering confidence.

Then, a decade ago, the situation began to change. Interest rates surged, putting pressure on banks and the thrift industry to finance riskier but potentially more lucrative investments. Meanwhile, distinctions among financial institutions began to blur. Not only did savings and loan associations begin moving away from traditional home mortgages into areas normally reserved for commercial banking, but loopholes in regulatory law allowed others to open "non-bank" banks.

A textbook case of how things can go wrong in the regulation of the financial services industry can be found in the Federal Home Loan Bank Board and its Federal Savings and Loan Insurance Corporation, which insures S&L deposits.

Early in this decade, S&Ls were allowed to move into new and risky areas. "Deregulation," it was argued, would allow flexibility for thrifts to compete effectively in the new economic environment in which they found themselves.

However, the government failed to invest in better regulatory systems to supervise a changing thrift industry and in the skilled people needed to more closely keep tabs on individual institutions. OMB, in a very short-sighted decision, denied the Bank Board's request for more staff. This lack of supervision was a prescription for disaster: poor management, risky loans, and outright fraud severely weakened the industry, especially in the Southwest, where the collapse of the oil and gas and real estate sectors worsened the situation. More than 500 thrifts are now insolvent.

Coping with this disaster will cost billions of dollars. Our estimate to close or merge insolvent S&Ls place the cost at $85 billion more than FSLIC's available resources. Some estimates place the figure as high as $100 billion or more. While healthy thrifts will pay part of the cost, the taxpayers will undoubtedly be forced to provide billions of dollars to finance the most extensive and expensive bailout in history.

Without fundamental change in the way the industry is regulated, there is little to prevent a recurrence of today's problems tomorrow. Correcting the problem that has been allowed to develop will require the industry to accept stringent standards which will be difficult for many individual S&Ls to meet. But in return for a taxpayer bailout, the Bank Board regulatory system must be replaced by a new structure. A new structure must put a priority on the safety and soundness of the system and sweep away the schizophrenic position of the Bank Board as both an industry advocate and regulator.

A reinvigorated regulatory environment must also include a commitment to personnel, including an enlarged corps of skilled examiners capable of finding and identifying problems before they get out of hand.

Implementing such an agenda will be very expensive. But it is the kind of investment we cannot afford to put off.

The Nuclear Weapons Complex

Let me turn, Mr. Chairman, to an area where you have devoted considerable personal attention and have been instrumental in bringing to the forefront of public policy issues--the enormous problems facing the nation's complex for producing nuclear weapons. As you well know, a vast federal investment is going to be needed to repair environmental damage and restore safe production capability.

Since World War II, nuclear weapons have played a dominant role in the nation's defense strategy. The Department of Energy oversees production of weapons in a complex of some 50 facilities located around the country. Despite the fact that nuclear weapons are a principal element of the nation's security, the facilities used to produce them have deteriorated and today present serious operational, safety, and environmental problems. We estimated, in our October 1988 testimony before this committee, that the investment needed to correct these problems will likely exceed $130 billion. Modernization plans under consideration, which include expanded plant capabilities and relocation of some facilities, could add at least another $15 billion to $25 billion.

Serious problems continue to surface at the nuclear weapons complex. These problems include:

-- Questions about the emergency cooling systems and seismic bracing at government reactors;

-- Deteriorating equipment and buildings, many at or beyond their expected lifetimes;

-- High levels of groundwater contamination;

-- Serious accidents that have been hidden from public scrutiny;

-- Inadequate radiological protection programs at buildings that process plutonium; and

-- Unanticipated shutdowns of nuclear operations due to safety and health concern.

In addition to upgrading the complex, essential tasks include (1) decontaminating obsolete facilities, (2) disposing of stored radioactive waste, and (3) cleaning up environmental contamination. In March 1987, we called for DOE to develop a strategic approach for prioritizing and addressing problems at the nuclear weapons complex; the Congress then mandated this study in the Defense Authorization Act for Fiscal Years 1988 and

1989. While DOE has reported to you on environmental problems at a number of its facilities, it has not yet issued the results of this mandated study. We will be following this issue closely and plan to review DOE's study when it is published.

While safe and modern facilities are essential, so is effective management. For several years, we have voiced serious concerns about the effectiveness of DOE's management and safety oversight of the weapons complex. In concert with developing its modernization strategy, DOE must strengthen its internal program for managing the complex. DOE needs to establish meaningful safety standards and emphasize to line managers their responsibility and accountability for dealing with safety and environmental problems.

Even with improved management, independent external oversight for the health and safety activities of DOE's nuclear facilities is essential. Your bill, Mr. Chairman, which subsequently became P.L. 100-456, established the Defense Nuclear Facilities Safety Board to fulfill this purpose. However, some production and waste storage facilities are exempt from the Board's oversight. Given the sensitivity of public concerns about nuclear power and DOE's track record, we believe that such oversight may need strengthening.

Finding the funds required for correcting the nuclear weapons complex will not be easy. But additional delays will only worsen the situation.

Defense

The military budget doubled between 1980 and 1985, and many observers -- myself included -- have long argued that many of the problems at the Pentagon stem from a buildup that was too much, too fast. Indeed, any realistic view of the budget debate would indicate that billions of dollars in weapon systems now on the drawing boards or underway will have to be cut to meet the spending limits that Congress will likely impose in coming years. Much of the debate over the defense budget has focused on hardware --the tanks, ships, and planes -- that claims the lion's share of the defense budget, while skirting questions about flawed management systems, antiquated personnel policies, and poor planning. For example, we may decide it is too expensive to build all the ships that the Navy wants. We need to have the management systems that would allow the Navy to design, build, test, and procure better ships with the limited resources it is allocated.

Over the past several years, we have identified numerous problems at the Pentagon. We've reported on dollars spent for unneeded inventories, on technical problems and cost overruns on major weapon systems, such as the B-1B bomber and the new air-to-air missile -- the AMRAAM -- and on inadequacies in the testing of new weapons. All of these problems and more have their roots in management systems that do not work well and/or in difficulties attracting, retaining, or effectively using quality people at all levels -- both military and civilian.

In short, DOD needs to balance strength with affordability and needs to pay greater attention to management systems and assuring it has highly qualified and experienced people to manage what is perhaps the most complex organization in the world. Steps that DOD and the Congress will need to take include the following.

1. Reduce and realign planned programs. In so doing, cancel marginal systems and delay systems not ready for production. Do not continue to buy new weapons at inefficient production rates which increase costs. Also, avoid the tendency to cut operation and support funds, which results in weapons that cannot be adequately supported.

2. The Secretary of Defense must provide sound fiscal guidance to the services. This will help ensure that requirements are realistically balanced with funding availability and that the 5-year defense program reflects achievable goals. Fiscally achievable defense plans contribute to greater program stability. Program instability has long been recognized as a

severe problem in managing weapon system programs.

3. Strengthen management and internal control systems. DOD is often too reactive rather than proactive in implementing its internal control programs. For example, DOD has billions of dollars of unneeded inventories, while, at the same time, certain U.S. forces are seriously short of such critical supplies as high-tech munitions and medical and petroleum supplies. Industry also needs to be closely examined to ensure that it has adequate internal control systems. It may be time to consider legislation which would require annual management reports by major contractors on their internal controls and an independent public accountant's opinion on management's representation.

4. Look for common missions and families of equipment to achieve greater efficiency. We have developed a variety of systems to accomplish the same mission. While some variety may be desirable, we must exercise greater restraint because we cannot afford to replace weapon systems on a one-for-one basis.

5. Improve operational test and evaluation (OT&E) of the weapons. The usefulness of OT&E in estimating a weapon system's performance has been limited because of insufficient resources to conduct testing, deferral of certain critical

tests until after the production decision, failure to simulate realistic battlefield conditions during testing, and acceptance of products which do not meet the test criteria. There is a need for greater vigor in OT&E and greater oversight over OT&E by the Office of the Secretary of Defense's Office of the Director of Operational Test and Evaluation.

6. Assess manpower and compensation systems, including retirement, with the goal of reducing costs. The cost of military personnel, including retirement, represents about 26 percent of the DOD budget. It is becoming too expensive to recruit, train, and retain highly skilled personnel and then have them retire at the peak of their careers. The average retirement age for enlisted personnel in 1987 was 41. The average for officers was 45.

   Reducing costs, however, should not be the only goal of this assessment. Given the magnitude of the funds involved, the complexity of the tasks, and the criticality of the mission, DOD also needs civilians of high quality and integrity and with sound qualifications and experience. Along these lines, increasing the professionalism of DOD's procurement workforce, which has often been outgunned by experts employed by contractors, is sorely needed.

7. The Secretary of Defense needs to carefully consider the long-term cost implications of adding new weapon systems to the DOD inventory. This need is perhaps best illustrated by the decision made in the early 1980s, at a time when DOD expected continued budgetary growth, to bring four World War II battleships back into the fleet. While the activation costs for these battleships were significant (nearly $2 billion), it will cost even more to operate and maintain them. For example, this year alone, three of the reactivated battleships will cost over $150 million to operate and will require about 4,600 Naval personnel. This comes at a time when defense costs must be contained.

8. Rethink the viability of U.S. worldwide commitments and current levels of U.S. allies' burdensharing. The rising costs of our worldwide commitments, in the absence of increased burdensharing by our allies, may simply be unaffordable. Any reassessment of our commitments should consider force structure reductions.

Environmental Cleanup

Significant inroads have been made over the past 20 years in addressing a host of environmental problems that have plagued the nation. However, environmental inquiry continues to identify additional threats to human health and the environment, such as indoor radon and stratospheric ozone depletion. Further, it has become increasingly evident that solutions to such problems are more complex than initially envisioned. Better management of the nation's environmental programs, requiring the efforts of both the Environmental Protection Agency and the Congress, will be needed to meet the challenges in the years ahead.

The situation facing EPA is especially complex. Rather than directly operating certain programs, as FAA and the Department of Energy do, EPA is largely responsible for assuring that others--the private sector and state and local governments--comply with environmental regulations. EPA relies heavily on the states to accomplish its mission. Moreover, the complex interplay of individual pollutants requires comprehensive regulatory strategy.

This situation poses a management challenge that cannot be solved by an investment of funds alone. The nation's environmental program must be managed with greater emphasis on achieving measurable environmental results. Specifically, EPA needs to

-- develop quantitative indicators of environmental quality and establish specific environmental goals;

-- link these goals to planning, budgeting, and financial management systems; and

- -- forge a new relationship with the states for carrying out the nation's pollution abatement efforts.

Our work in the hazardous waste area is illustrative of the problems facing EPA. The Resource Conservation and Recovery Act of 1976 required EPA to, among other things, identify and develop regulations for controlling hazardous wastes and ensure compliance with the regulations. While EPA has identified more than 450 specific wastes, the potential universe is much greater. We found that EPA's limited progress in regulating additional wastes is due to its lack of focus and an absence of a comprehensive program strategy. In 1988, we recommended that EPA establish specific, measurable long-term goals for its waste management program and strategies for accomplishing them.

One of the most troubling aspects of EPA's hazardous waste program is that federal agencies, which might be expected to be models of compliance, have very poor compliance records. For example, DOD has estimated that cleaning up military installations and bringing them into full compliance with hazardous waste standards could cost as much as $14 billion.

Strengthening EPA's management of environmental programs will require close cooperation between the agency, states, and the Congress. We have called on EPA to consider revamping its relationship with states in monitoring and enforcing environmental programs. It is also time for EPA and the Congress to work together in identifying the goals of environmental policy and determining the priorities for achieving long-term solutions.

The IRS

As the tax collector for the nation, the Internal Revenue Service deals with virtually every American, every year. The IRS once enjoyed a reputation for running the finest tax collection system in the world. It was emulated by other nations envious of its efficiency and of the American public's remarkable record of voluntary tax compliance. Many state and local tax codes were designed to complement the federal tax code, and local tax agencies looked to the IRS as a model for their own efforts.

Today, the IRS faces a number of worrisome problems, as management and program reviews by GAO have revealed.

One symptom of trouble is the fact that IRS examined 42 percent fewer returns in 1987 than it did in 1978 -- a decline from 2.3 percent to 1.1 percent of filed returns. The agency estimates that taxpayers will fail to pay more than $87 billion in taxes owed in 1988, and that this amount could exceed $100 billion by 1992. Fewer audits and lax collection and enforcement fuel a belief that many taxpayers are cheating the system, inviting public cynicism about its fairness.

To improve its enforcement efforts as well as the general efficiency of the agency, the IRS must invest heavily in new automated systems, replacing those designed 20 or 30 years ago. If you live in the Boston area, for instance, your return is processed locally by a very antiquated system. The data must then be sent to West Virginia, where it is entered into the central system. Finally, if you are due a refund, the Treasury office in Philadelphia must be notified to process the check. Each movement in this chain involves delay and invites errors. Today's automated systems are capable of far greater speed and efficiency. Designing, building, and installing new automation systems for the IRS is critical.

But better systems alone won't solve the IRS' problems; the agency must also invest in people. The IRS must attract top graduates in the accounting, legal and computer science fields--a task that is increasingly difficult as federal pay in these jobs lags behind the private sector more every year. While all government agencies face problems in competing for qualified people, the need is especially acute at IRS. If the agency cannot attract highly qualified people, it will surely find itself at a disadvantage in dealing with lawyers and accountants from private firms. For an agency so central to the operations of government, we call ill-afford outdated systems and a work force that is less than the best.

Air Transport and the FAA

One of the hallmarks of a modern industrial state is an efficient, effective, and safe transportation system. While railways, highways, and waterways remain important movers of goods and people, the airways are clearly our fastest-growing mode of transportation. Unfortunately, our airways today are often associated with congestion, delays, and a greatly increased concern about safety.

The simple truth is that air traffic growth has outpaced our investment in the facilities and people needed to manage it. Annual passenger air travel nearly doubled in the last decade, and is projected to nearly double again by the turn of the 21st century. The pressure on the Federal Aviation Administration to develop new or upgraded automated systems and hire significant numbers of controllers and other personnel is substantial.

In 1981, FAA unveiled its national airspace system plan for replacing aging air traffic control equipment. Initially envisioned as a comprehensive means of scheduling all capital improvements needed until the year 2000, this plan represented the largest civilian technology project since the Apollo space program. On the basis of projected costs and schedules, legislation was passed to ensure financing by the Airport and

Airway Trust Fund, through such sources as an 8-percent tax on passenger tickets.

Today, the plan no longer represents the full extent of needed modernization. While some new projects have been incorporated, others have not. We have estimated the cost of all modernization projects at $25 billion by the year 2000, more than double the original plan estimate in 1981. That projected cost far exceeds existing reserves in the Trust Fund. The adequacy of Trust Fund revenues to finance continued modernization cannot readily be determined. So that this may be done, the National Airspace System plan needs to be revised to reflect the totality of modernization projects together with associated costs and schedules.

FAA also needs to step up its investment in people. Seven years after the 1981 air traffic controller strike, fully qualified controllers number almost 4,000 fewer than before the strike. Moreover, some 4,300 technicians who maintain air traffic control equipment -- over half the current work force -- are expected to retire by 1995.

FAA has underestimated its staffing requirements for three critical workforces -- air traffic controllers, aviation safety inspectors, and maintenance technicians. Without adequate staffing standards, FAA has not been able to ensure that its budget requests reflect actual needs and, in fact, the Congress has approved funding levels that differ from those requested. In addition to reliable staffing standards, FAA needs a clear recruitment policy and a coordinated recruitment program if it is to overcome difficulties and attract and retain a high-quality workforce.

With air transport increasingly important to both commerce and the traveling public, delays in bringing to fruition the new systems and hiring skilled personnel will only aggravate a system already stretched thin.

WHAT MUST BE DONE?

What must be done? We certainly do not pretend to have all the answers. However, our series of 26 transition reports do provide some suggestions.

Addressing the budget deficit is clearly the first and foremost action that must be taken. If we procrastinate or fail, the nation's economic future will be at risk and our ability to deal with operational problems and crises that are bound to occur will be imperiled. Our first transition report lays out an approach for Congress and the administration to begin addressing the deficit.

Additional revenues are probably an unavoidable part of any realistic strategy for reducing the deficit. Our third transition report discusses revenue options frequently proposed. Because each option alone has some drawbacks, a combination of these options could emerge.

Both Congress and the administration must begin to view and address problems from a longer term perspective, rather than focusing on short-term consequences and "quick fixes" that often result in even more serious problems down the road. Both central and line agencies must assume responsibility for operational problems.

Something is basically wrong with our approach to making budget and management decisions to have allowed such problems as I described earlier with our delivery of vital government services to have existed so long. OMB is a key agency that needs to change to improve this situation.

In reality, OMB's approach is a product of the way the entire government looks at problems and issues. Presidents, the Congress, and agencies also have to share the responsibility. The budget deficit and our reluctance to deal effectively with it have resulted in too many short-sighted decisions.

But OMB is the key agency in the executive branch that should have the foresight and perspective to understand the long-term implications of not adequately addressing key problems. Unfortunately, OMB's history has mitigated against it taking that perspective. And, partly because of that, poor decisions have been made. Focus on the short-term consequences of actions -- as we did in the savings and loan area -- has often resulted in long-term problems of an even larger magnitude than imagined.

To help reverse the disinvestment in people and management systems that has occurred, I would like to point the Committee's attention to four of our transition reports that deal on a governmentwide basis with this issue. They contain a variety of specific suggestions for governmentwide consideration on how to attract quality people for the public service and improve the way government manages its major computer and telecommunications systems, financial and budget affairs, and program evaluation information.

For example, as a foundation for dealing with the "people problem," our report on the public service urges a rebuilding of the image of the public service, changes to address the pay and benefit structure, and making ethics in government a priority of political appointees. We cannot continue to expect to make progress in this area by saying that all solutions must be "budget neutral." We also cannot continue to require that agencies absorb the costs of all pay and benefit increases. OPM needs to take a more effective leadership role in helping assure that the federal workforce is up to the task at hand.

To manage costly, and often one-of-a-kind, federal computer systems effectively, our report on information technology issues urges greater agency top management attention to the role and importance of strategic planning and the need to control specific projects through each phase of initiation, development, and operation. Currently, there is a governmentwide shortage of technical staff in this area. To deal with this situation, we urge in this report the establishment of special salary scales for technical personnel, along with other actions.

There are many facets to be considered in improving the government's financial and budget affairs. Overall, I believe a broad restructuring and rebuilding of our overall financial management structure is essential and deserves a top priority of the new administration and Congress. To be most effective, reform must be governmentwide, serving the needs of both Congress and the executive branch. As discussed in some detail in our transition report on financial management issues, modernizing the federal financial management structure means we need to consider restructuring the budget to include capital and operating subtotals, sound financial accounting and reporting, effective internal controls, and strong auditing of financial information and program operations.

One issue in this transition report I would like to emphasize is the need to restructure the budget to give greater visibility to separate totals for capital expenditures and for the operations of the trust funds. Over the years GAO has pointed out the need for improvements in the structure and content of the budget. For example, in testifying last year before this Committee I said that particular attention needs to be given to developing a budget that better distinguishes between capital and operating amounts. I noted that by combining capital and operating amounts, the current budget structure blurs an important distinction which can result in a bias against major long-term investments, such as replacing the government's antiquated computers and systems. Some of the very costly modernization projects discussed in our transition reports, which I have already mentioned, further point out the need for a separate budget for proposed long-term capital expenditures.

More recently, in our transition report on the budget deficit, we pointed out the extent to which the large and growing surpluses in the Social Security and other trust funds are masking the continuing huge deficit in the general operations of government. As I noted earlier, the fiscal year 1988 deficit was much less because of the $97 billion in trust fund surpluses. For fiscal years 1989 and 1990, the estimated trust surpluses of $116 and $127 billion mask the deficit even more.

Our report on program evaluation issues points out that with few exceptions program evaluation and data collection capabilities have been gravely eroded in the executive branch. The infrastructure -- the capacity for program evaluation -- has to be rebuilt in some agencies. Resources need to be dedicated to program evaluation. Priorities need to be set. And honest full reporting of problems and potential solutions, both to agency policymakers and Congress, is needed.

In all of these areas OMB and key line agencies have roles to play. OMB needs to understand much better the problems agencies have and what it takes to solve them. It needs to work closer with the agencies to develop a longer term financial and management strategy to get there and better explain to the President and Congress the consequences of not following the longer term strategy. It needs more professionals to do this job well. Teams which blend program and management expertise during the budget process are critical to successfully changing OMB's approach. Equally important, however, is the commitment of the President and OMB leadership to such efforts.

Another key to management progress is not to use just OMB, with its limited staff, to impose change or attempt to manage agency operations. Rather, the administration must enlist the commitment of the line agency executives to address difficult problems. OMB can play a useful role in (1) demonstrating the existence of a problem, (2) providing the necessary policy framework to guide agency efforts, (3) providing the external influence and support useful to agency officials in overcoming opposition to change within agencies, and (4) coordinating those issues which cross agency boundaries.

However, agencies bear primary responsibility for addressing their own management issues. OMB's efforts should not be seen as alleviating the accountability of agency heads for addressing agency problems and successfully carrying out long-term plans and programs within fiscal guidance.

- - - - -

In conclusion, Mr. Chairman, many of the problems facing the Congress and new administration are critical and immediate. We look forward to working with your Committee to help the Congress address these problems.

This concludes my remarks. We would be pleased to answer questions.

TRANSITION SERIES

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

United States General Accounting Office

GAO

Testimony

For Release
on Delivery
Expected at
9:30 a.m.
Wednesday
January 18, 1989

Transition Issues:
Overview of GAO's Transition Series Reports

Supplement to Statement of
Charles A. Bowsher
Comptroller General

Before the
Committee on Governmental Affairs
United States Senate

AN OVERVIEW OF GAO'S TRANSITION SERIES REPORTS

In November 1988 GAO issued 26 transition reports addressed to Congress, the President-elect, and the Secretary-designates of the departments and agencies of the executive branch. Each report covers a separate subject area, giving the incoming administration GAO's views of the most important policy, management, and program issues and problems that need to be addressed. Some of the issues are relatively new, while others represent long-standing and unresolved problems.

The first eight reports cover governmentwide issues--the budget deficit, public service, revenue options, information technology, financial services, international trade, financial management, and program evaluation. The remaining reports address specific issues or concerns associated with the programs, policies, or management of 18 departments or agencies. The following briefly highlights the major message of each report. Appendix I provides an outline of eight transition reports that discuss governmentwide issues and problems and Appendix II provides an outline of 18 transition reports that discuss agency-specific concerns.

GOVERNMENTWIDE ISSUES

The Budget Deficit (GAO/OCG-89-1TR)

This report presents an approach for dealing with the budget deficit, which we believe is one of the most important issues the new President and Congress need to address. If better control over the deficit is not achieved, it will be exceedingly difficult to implement any new initiatives to deal with the array of needs in the country--be they more money for AIDS research, more money to assure a good air safety system, or more money for needed weapons systems.

The Public Service (GAO/OCG-89-2TR)

This report addresses an issue that is not as visible as most but may be more important--the need to assure that the government has top-quality people to carry out the programs of the President and Congress and hold them accountable for achieving results. The laws, regulations, and processes of government are only as good as the people who have to carry them out. All too often not enough attention has been paid to these critical factors--quality people and accountability--needed to assure successful implementation of government programs.

Revenue Options (GAO/OCG-89-3TR)

This report describes the key points raised in our recent work, and in the work of others, concerning certain revenue options frequently proposed: raising income tax rates, broadening the income tax base, enacting a consumption tax, increasing revenue from federal excise taxes, and strengthening IRS enforcement. A combination of these options could emerge because each option alone has some drawbacks.

Based on past experience it will be extremely difficult to bring down the deficit solely through management efficiencies and spending cuts. Many people, including those involved in domestic and overseas financial markets and institutions, would not view any deficit reduction effort as credible without some revenue increases. Therefore, the Congress and the administration must carefully consider the advantages and disadvantages of various revenue options available to deal with the deficit.

Financial Services Industry Issues (GAO/OCG-89-4TR)

This report identifies four important issues we believe should be included in whatever agenda Congress and the Secretary of the Treasury, as well as the heads of banking, thrift, securities, and futures regulatory agencies set for considering our Nation's financial services industry. They are (1) handling troubled financial institutions, (2) regulating the merging of banking and nonbanking lines of business, (3) regulating linked securities and futures markets, and (4) regulating global capital markets.

International Trade Issues (GAO/OCG-89-5TR)

This report identifies five important issues in the area of international trade and economic policy. They are (1) conducting economic policy in an interdependent world, (2) trade negotiations and agreements, (3) improving the management of export promotion and market development programs, (4) improving export controls, and (5) foreign direct investment in the United States. While there are undoubtedly many other issues that will demand attention, we believe those outlined in this report should be included at the top of the agendas of the Secretaries of Commerce, Agriculture, and Treasury, and the United States Trade Representative.

Information Technology Issues (GAO/OCG-89-6TR)

Effective government depends directly on effective automation to support programs and initiatives. Virtually all facets of government rely on technology, but management of this technology has been uneven. Critical areas have not been given focused attention, and major computer and telecommunications systems have met with mixed success.

The possibility for significant improvement is at hand. This report describes the environment in which information technology has been managed and identifies four areas that need attention: (1) strategic planning that ties agencies' technology to their missions, (2) systems development projects that provide technical capability, (3) security that protects sensitive information, and (4) personnel who oversee complex automated systems. These areas, all of which are undergoing rapid changes, provide vital support to government operations. The new administration and the Congress have an opportunity to make lasting improvements to government services by improving management of the technology that supports these services.

Financial Management Issues (GAO/OCG-89-7TR)

Over the past several years, GAO has done a considerable amount of work related to improving the government's financial management. This report summarizes our position on key elements of financial management reform which have emerged from this work.

While there are many facets to be considered in rebuilding the government's financial management structure, these are the four components which we believe deserve the highest priority of the new administration and Congress.

-- Restructure the budget to include capital and operating subtotals for general, trust, and enterprise activities, and reformulate deficit reduction targets to correspond with the revised budget structure.

-- Develop politically binding agreements on multiyear macro budget targets between the White House and Congress in a fashion similar to those set during the legislative-executive budget summit of 1987.

-- Establish a chief financial officer structure for the government, which would provide leadership and direction for financial systems, reporting, and internal control improvements.

-- Retain the President's Council on Integrity and Efficiency and continue its activities to coordinate inspector general efforts to prevent and detect fraud, waste, and abuse.

Financial management reform of this nature is urgently needed to better manage the government's financial affairs, potentially save billions of dollars, and help restore the accountability of managers and the credibility of government in the eyes of the public.

Program Evaluation Issues (GAO/OCG-89-8TR)

In this report, we are concerned with the government's continuing ability to develop, disseminate, and use information. Production of sound and timely information is one of the most critical functions of government. Program evaluation--along with supporting data collection--is one of the best means available for obtaining it. Yet with few exceptions, we have found that both program evaluation and data collection capabilities have been gravely eroded in the executive branch.

For executive agencies to preserve their proper role in policy and program implementation, four actions are needed: (1) rebuilding staff capacity, (2) providing dedicated resources for program evaluation and data collection, (3) setting priorities to ensure that information arrives when needed, and (4) ensuring honest, full reporting, both to agency policymakers and to Congress.

AGENCY-SPECIFIC CONCERNS

Defense Issues (GAO/OCG-89-9TR)

This report identifies five important issues we believe should be included in whatever agenda the Congress and the Secretary of Defense set for our nation's defense program. These issues are (1) reducing defense costs, (2) maintaining readiness and sustainability of defense forces, (3) improving the weapon systems acquisition process, (4) improving peacetime inventory management, and (5) ensuring a first-rate management team.

Health and Human Services Issues (GAO/OCG-89-10TR)

This report highlights actions that should be taken in four critical areas affecting the large and diverse operations of the Department. These include (1) improving departmental management, (2) containing the cost of health care, (3) enhancing the financing and delivery of social security benefits, and (4) implementing the recently enacted welfare reform legislation.

Commerce Issues (GAO/OCG-89-11TR)

This report identifies four important issues we believe should be included in whatever agenda Congress and the Secretary of Commerce set for the Department. They involve the need to (1) improve the Department's export promotion activities, (2) improve export controls, (3) address planning and decisionmaking problems associated with the decennial census, and (4) monitor progress on development of the new automated patent system.

Agriculture Issues (GAO/OCG-89-12TR)

This report on the Department of Agriculture describes our concerns about (1) improving the effectiveness and reducing the costs of farm programs, (2) reducing the cost of Farmers Home Administration loan programs, (3) finding long-term answers to reduce the dairy surplus, (4) strengthening the financial viability of the Federal Crop Insurance Program, (5) enhancing U.S. agricultural competitiveness, and (6) improving the delivery of food stamp benefits. We also offer a wide range of observations and suggestions about how the Secretary of Agriculture can best address these concerns.

Justice Issues (GAO/OCG-89-13TR)

The four issues we believe should be included in whatever agenda Congress and the Attorney General set for the Department of Justice are (1) improving overall departmental management, (2) reassessing the effectiveness of drug abuse control programs, (3) planning for the potentially staggering costs of sentencing reform, and (4) determining whether immigration reform is working. We studied the management of the Department of Justice and reported to Congress in 1986 that the Department's central management needed strengthening. In 1988 we issued a special status report on controlling drug abuse that provided an overview of the drug problem and federal efforts to deal with it.

Veterans Affairs Issues (GAO/OCG-89-14TR)

This report highlights important issues identified through our work over the past several years that affect the nation's ability to deliver effective and equitable services to its veterans. The four issues that we believe should be included in the agenda the Congress and the Secretary set for the new department are (1) improving overall departmental management, (2) planning to meet the long-term care needs of a burgeoning population of aging veterans, (3) reassessing the schedules used to set compensation levels for disabled veterans, and (4) modernizing information systems.

VA has begun to take steps to address these issues. A new Secretary of Veterans Affairs will need to direct efforts to improve the overall management of the medical and benefit programs and thereby enhance the delivery of services to the nation's veterans.

NASA Issues (GAO/OCG-89-15TR)

This report identifies three important issues we believe should be included in whatever agenda Congress and the Administrator of NASA set for the agency. They are (1) providing better information on where NASA is headed and at what cost, (2) minimizing the future cost of the space station, and (3) launching deep space science missions on time. We expect to identify other issues in the near future since we have expanded our work effort at NASA in anticipation of its recovery from the Challenger accident and the Agency's increased efforts on other major programs, such as the space station.

Energy Issues (GAO/OCG-89-16TR)

This report on the Department of Energy describes our concerns about the following issues: (1) modernizing and managing the safe operation of the Department's nuclear weapons complex, (2) reducing the nation's vulnerability to oil disruptions, (3) developing a nuclear waste program, (4) commercializing clean coal technologies, (5) responding to changes in the electric utility industry, (6) improving controls over the export of sensitive nuclear data, and (7) revitalizing the uranium enrichment program.

Treasury Issues (GAO/OCG-89-17TR)

As a leader in formulating economic policy, improving financial management, and regulating financial institutions, the new Secretary of the Treasury must help address many daunting challenges. These include (1) restoring stability to a shaken financial services industry, (2) developing policies to address the pressing U.S. trade deficit, and (3) enhancing reform efforts to improve the government's second-rate accounting systems.

The new Secretary also must address serious problems within Treasury. Significant internal control weaknesses are undermining the Department's effectiveness in controlling trillions of dollars. There is a critical need to monitor the progress of major new information systems, such as IRS's total redesign of the tax processing system.

Education Issues (GAO/OCG-89-18TR)

The new President has pledged to improve the nation's educational system, and we believe that the actions we are recommending will strongly influence how well the Department carries out this mandate. Briefly, the issues in this report discuss the need to (1) reduce the cost and preserve the integrity of higher education programs, (2) enhance the federal role in elementary and secondary education programs, and (3) strengthen departmental management.

Department of State Issues (GAO/OCG-89-19TR)

This report identifies four important issues that we believe should be included in the agenda the Secretary of State and Congress set for the management of our nation's foreign affairs. They are (1) management deficiencies, (2) improving U.S. participation in United Nations organizations, (3) improving effectiveness of the international narcotics control program, and (4) improving administration of refugee programs.

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

This report on the Environmental Protection Agency (EPA) describes our concerns about (1) improving the overall management of the nation's environmental protection efforts (on the basis of the results of our general management review of EPA completed in August 1988), (2) improving the management of hazardous waste and the cleanup of abandoned waste sites, (3) creating a new policy to reduce ozone levels, (4) focusing increased attention on pesticide health and environmental assessments, and (5) developing a more comprehensive approach to cleaning up the nation's waterways. We also offer a wide range of observations and suggestions on how the Administrator of EPA can best address these concerns.

Department of Labor Issues (GAO/OCG-89-21TR)

This report highlights major policy, management, or program issues that need attention by the Secretary of Labor. Some are relatively new, while others represent long-standing and unresolved problems. If these issues are addressed properly, the Secretary will better accomplish the Department's key responsibilities for ensuring safe and healthful workplaces and for promoting the welfare of wage earners, and will improve the overall management of the Department.

Specifically, the issues we believe the Secretary should place the most emphasis on are (1) improving the Occupational Safety and Health Administration's enforcement program, (2) enhancing the use of Job Training Partnership Act resources, (3) developing a strategy to address recessionary problems, (4) implementing the new dislocated worker assistance program, and (5) sustaining Department management improvements. These issues were identified through our general management review of the Department of Labor as well as other work we have done at the Department.

Housing and Urban Development Issues (GAO/OCG-89-22TR)

This report on the Department of Housing and Urban Development describes our concerns about two important issues that need closer attention--low-income housing and homelessness. If these issues are not addressed, the Secretary of Housing and Urban Development can expect (1) continuing decreases in the supply of rental housing that is available and affordable to low-income people amd (2) a growing national homelessness problem. In this report, we offer a wide range of observations and suggestions on how the Secretary of Housing and Urban Development can best address these concerns.

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Discussed in this report are key issues relating to the foreign economic assistance programs of the Agency for International Development (AID). Three broad categories of issues are addressed: (1) reexamining AID's role in critical policy areas, (2) improving AID management and administration, and (3) strengthening accountability and control over assistance. Because the bilateral assistance program represents such an important link between the United States and the developing world, we believe that these issues need to be considered in efforts to design an effective program for the 1990s.

Interior Issues (GAO/OCG-89-24TR)

This report on the Department of the Interior summarizes several issues concerning Interior's stewardship and fiduciary responsibilities. It describes our concerns about the need to (1) balance better the competing demands on and increase funding for natural and cultural resources and (2) provide assurances that revenues due the government are being collected. We also offer a wide range of observations and suggestions on how the Secretary of the Interior can best address these concerns.

Transportation Issues (GAO/OCG-89-25TR)

This report, on the Department of Transportation, describes our concerns about (1) meeting transportation challenges through strong secretarial leadership, (2) revising the plan to modernize the air traffic control system, (3) improving the Federal Aviation Administration's effectiveness, (4) improving management of transportation infrastructure, and (5) reassessing the Coast Guard's role. We also offer a wide range of observations and suggestions on how the Secretary of Transportation can best address these concerns.

Internal Revenue Service Issues (GAO/OCG-89-26TR)

In this report we summarize several tax administration issues that need closer attention. If these issues are not addressed, the Commissioner can expect serious problems in processing tax returns, a decline in taxpayer confidence in the tax system, and a significant loss in tax revenues that could help reduce the deficit.

IRS needs to (1) modernize its information technology, (2) strengthen human resources, (3) improve collection activities, and (4) narrow the tax gap. As discussed fully in our October 1988 report on overall management at IRS and in other GAO reports and testimonies, IRS has agreed to take steps to resolve many of these issues. A new Commissioner of Internal Revenue will need to direct and encourage those efforts to improve the overall management of the nation's tax system and collect additional revenues.

OUTLINE OF ISSUES AND PROBLEMS DISCUSSED IN GOVERNMENTWIDE TRANSITION REPORTS

GAO/OCG-89- Page

- 1TR THE BUDGET DEFICIT
  - Resolve the Budget Deficit 4
    - The situation is worse than it seems 6
    - Solving the problem 11
    - Achieving consensus 14
  - Related GAO Products 17
- 2TR THE PUBLIC SERVICE
  - Improve the Public Service 4
    - Image building 4
    - Addressing pay problems 5
    - Achieving accountability 7
  - Related GAO Products 13
- 3TR REVENUE OPTIONS
  - Raise Income Tax Rates 4
    - Revenue gains are potentially large 4
    - But many are reluctant to raise rates after tax reform 4
  - Broaden the Income Tax Base 6
    - Each tax preference item has strong backing 7
    - But some tax preferences could be made less costly through narrower targeting 8
  - Enact a New Consumption Tax 11
    - The potential for revenue gains would be substantial 12
    - How the value added tax works 12
    - Would a VAT improve our domestic and international economic position? 13
    - Basic concerns in designing a VAT 14
    - What would it cost to administer a VAT? 15
  - Increase Revenue from Federal Excise Taxes 16
    - Restore erosion from inflation 17
    - Raise the rates or equalize them among similar products 17
    - Broaden the base 18
    - Enact new excise taxes 19
  - Increase Internal Revenue Service Enforcement 20
    - Reduce the tax gap 20
    - Increase examination resources 20
    - Improve collection activities 21
  - Increase Non-Tax Revenue Sources 22

Increase reliance on user charges 22
Selling federal assets 22
Gains through economic growth 23
Related GAO Products 25

4TR FINANCIAL SERVICES INDUSTRY ISSUES
The Financial Services Industry 3
Reestablishing Financial Stability in the Thrift Industry 5
Managing the Deregulation of Banks 9
Regulating Linked U.S. Financial Markets 12
Regulating Globally Linked Markets 15
Related GAO Products 19

5TR INTERNATIONAL TRADE ISSUES
Conducting Economic Policy in an Interdependent World 4
Trade Negotiations and Agreements 6
Improve Management of Export Promotion and Market Development Programs 9
Commerce Department programs 9
Agriculture Department programs 11
Needed Changes in Export Controls 13
Foreign Direct Investment in the United States 17
Related GAO Products 21

6TR INFORMATION TECHNOLOGY ISSUES
The Information Technology Environment in the Federal Government 4
Strategic Planning 9
Systems Development Projects 12
Automated Information System Security 15
Technical Personnel 18
Related GAO Products 22

7TR FINANCIAL MANAGEMENT ISSUES
Reaching for Financial Management Reform 6
The Federal Budget: A Process in Need of Change 10
A restructured budget 10
Streamlining the budget process 12
Improving the budget's numbers and cost information 14
Proposed solutions 16
Sound Financial Systems and Reporting: A Major Need 18
Financial systems are weak and outdated 19

Where is financial management reform headed? 21
Providing central leadership and continuing direction 22
Supporting financial management reform through legislation 24
Effective Internal Controls: An Ongoing Commitment 26
Inspectors General: A Strong Corps Made Stronger 29
Maintaining continuity of IG leadership 30
Work of the President's Council on Integrity and Efficiency 31
Newly authorized IGs 31
Related GAO Products 33

8TR PROGRAM EVALUATION ISSUES
Why Program Evaluation Is Important 6
The Current Decline in Evaluative Capability 9
Evaluation Findings in Specific Agencies 12
Inadequacies of DOD evaluative data 12
Tough Medicare issues 14
Adequacy and availability of EPA regulatory data 15
Education: C- on information 16
Rebuilding Capacity 19
What is needed: capacity 19
What is needed: resources 20
What is needed: priorities 21
What is needed: honest reporting 21
If Agencies Don't, Others Will 23
Related GAO Products 26

OUTLINE OF ISSUES AND PROBLEMS DISCUSSED IN AGENCY-SPECIFIC TRANSITION REPORTS

GAO/OCG-89- Page

9TR DEFENSE ISSUES
- Reducing Defense Costs 4
- Maintaining Readiness and Sustainability of Defense Forces 8
- Improving the Weapon Systems Acquisition Process 10
- Improving Peacetime Inventory Management 13
- Ensuring a First-Rate Management Team 15
- Related GAO Products 16

10TR HEALTH AND HUMAN SERVICES ISSUES
- Managing the Department 4
  - Initiate departmental planning 4
  - Initiate workforce planning 6
  - Invest in management support systems 8
  - Restructure role of chief of staff 9
- Financing the Cost of Health Care 12
  - Refine Medicare's hospital prospective payment system 12
  - Controlling Medicare costs for physician and related services 15
  - Financing long-term care 16
- Financing and Delivering Social Security Benefits 18
  - Preserve the Social Security Trust Fund 18
  - Enhance public confidence in the Trust Fund 20
  - Improve operations so that SSA provides quality service efficiently 21
  - Develop measures of performance and service quality 23
- Strong Leadership Needed to Implement Welfare Reform 25
  - Reorienting welfare 26
  - Strengthening programs to promote parental responsibility 27
- Related GAO Products 32

11TR COMMERCE ISSUES
- Improve U.S. Export Promotion Activities 4
- Needed Changes in Export Controls 8
- Early Planning and Timely Decisions Needed to Control Escalating Decennial Census Costs 12
  - Action needed now for the 1990 Decennial Census 12

- Early planning and timely decisionmaking for the 2000 Decennial Census needed 14
- Closely Monitor Development of the New Automated Patent System 17
- Related GAO Products 19

12TR AGRICULTURE ISSUES

- Improving the Effectiveness and Reducing the Cost of Farm Programs 4
  - Achieving desirable levels of grain stocks 4
  - Adding more flexibility to production controls 7
  - Easing the administrative burden 8
- Reducing the Cost of FmHA Loan Programs 11
  - Revising loan-making criteria 12
  - Helping farmers graduate to alternative sources of credit 13
- Finding Long-Term Answers to Reduce the Dairy Surplus 15
  - Curtailing surpluses with short-term solutions 15
  - Developing a long-term strategy to curtail surpluses 16
- Strengthening the Financial Viability of the Federal Crop Insurance Program 19
  - Undermining FCIC's financial viability 19
  - Reestablishing controls over private companies selling crop insurance 20
- Enhancing U.S. Agricultural Competitiveness 23
  - Using marketing strategies to increase exports 23
  - Improving management control over export programs 25
- Improving the Delivery of Food Stamp Benefits 28
  - Reforming the food stamp sanction system 28
  - Improving benefit delivery 31
- Related GAO Products 33

13TR JUSTICE ISSUES

- Strengthen the Department's Central Management Capability 4
- Develop Information Needed to Set Budgetary Priorities for Anti-Drug Programs 7
- Identify Effects of Sentencing Reform 10
- Determine Whether Immigration Reform Is Working 14
- Increase Efforts to Prevent Discrimination Due to Immigration Reform 16
- Related GAO Products 17

14TR VETERANS AFFAIRS ISSUES

Managing Program Operations 4
  Assuring quality of field facilities' services 4
  Improving efficiency of medical centers 7
Serving Veterans' Long-Term Care Needs 9
  Planning to meet increased demand 9
  Assessing veterans' nursing home needs 13
Compensating Veterans' Disabilities 15
Modernizing Information Systems 18
Related GAO Products 21

15TR. NASA ISSUES

NASA Must Develop a Strategic Plan and Report Full Project Costs to the Congress 4
NASA Must Institutionalize a Life-Cycle Cost Management Process for the Space Station 7
NASA Must Launch Deep Space Science Missions on Schedule to Avoid Costly Delays 9
Related GAO Products 12

16TR ENERGY ISSUES

Modernizing and Safely Operating the Nation's Nuclear Weapons Complex 4
  The nuclear weapons complex has deteriorated 4
  DOE lacks adequate oversight 6
Reducing U.S. Vulnerability to Oil Disruptions 8
  The transportation sector 8
  The Strategic Petroleum Reserve 9
  Other emergency response measures 10
  The economic and regulatory atmosphere 11
Developing a Credible Program for Nuclear Waste Disposal 13
  Establish capacity of Yucca Mountain now 14
  Reassess storage facility benefits 15
  Address uncertainties of Waste Isolation Pilot Plant 17
Commercializing Clean Coal Technologies 19
  Clean Coal Program should focus on promising technologies 19
  Controlling acid rain should be linked to clean coal technologies 20
Responding to the Changing Infrastructure of Electric Utilities 23
  Non-utility sources of electricity supply are increasing and utility corporate structures are changing 23
  Federal regulatory purview over electric utility activities is expanding 25

- Improving Control Over Nuclear Weapons Information, Technology, and Exports 27
  - Controls do not protect unclassified weapons information 27
  - DOE is faced with conflicting legislation 29
- Revitalizing the Nation's Uranium Enrichment Program 32
  - Conflicting program objectives 32
- Related GAO Products 35

17TR TREASURY ISSUES

- Restoring Stability to a Troubled Financial Services Industry 4
  - Dealing with insolvent institutions 4
  - Regulating the banking industry 5
  - Coping with a volatile market 6
  - Operating in an increasingly international arena 7
- Formulating Economic Policies to Address the Trade Deficit 8
- Ensuring Financial Management Reform 9
- Managing Treasury's Critical Information Technology Challenges 10
- Addressing Treasury's Serious Internal Control Problems 14
- Working With the New Inspector General 18
- Related GAO Products 19

18TR EDUCATION ISSUES

- Reducing the Cost and Preserving the Integrity of Higher Education Programs 4
  - Improve collections and reduce defaults 5
  - Better incentives needed to improve performance 8
  - Improve program monitoring 10
- Enhancing the Federal Role in Elementary and Secondary Education Programs 12
  - Provide better guidance for program implementation 12
  - State data for congressional and management oversight limited 14
- Strengthening Departmental Management 16
  - Increased secretarial involvement could improve federal impact 16
  - Improve financial management 18
- Related GAO Products 20

19TR DEPARTMENT OF STATE ISSUES

- Management Deficiencies 4

- Strong management needed for overseas construction and property 6
- Overseas properties need improved maintenance 7
- State needs to provide adequate overseas administrative support to other agencies at a reasonable cost 9
- Improved internal controls are required 10

Improving U.S. Participation in United Nations Organizations 13

Improving Effectiveness of International Narcotics Control Program 16

Improving Administration of Refugee Programs 18

Related GAO Products 20

20TR ENVIRONMENTAL PROTECTION AGENCY ISSUES

Improving Overall Environmental Program Management 4
- Focus on measurable results 4
- Link goals to planning, budgeting, and financial management systems 6
- Develop a more effective EPA-state partnership 7

Managing Hazardous Waste Programs Better 9
- Improving focus and direction of today's hazardous waste program 9
- Improving Superfund's management strategy 10
- Encouraging federal sector compliance 12
- Evaluating threats from nonhazardous waste 13

Creating a New Policy to Reduce Ozone Levels 16

Focusing Increased Attention on Pesticide Health and Environmental Assessments 20

Developing a Comprehensive Approach to Control Surface Water Pollution 23

Related GAO Products 25

21TR DEPARTMENT OF LABOR ISSUES

Improve OSHA's Enforcement Program 4
- Expedite standard-setting 5
- Better data needed for targeting inspections 6
- Enhance monitoring of state programs 7
- Strengthen working relationships 7

Better Target Job Training Resources 9
- Little evidence of targeting to those most in need 10
- On-the-job training 12

Develop a Contingency Plan to Address Recessionary Problems 14

Build adequate unemployment insurance reserves 14
Anti-recessionary actions should be quick-acting and targeted 15
Assure Effective State Implementation of Dislocated Worker Rapid Response Program 19
Factors associated with success 19
Respond rapidly to serve dislocated workers 20
Sustain Management Improvements 22
Maintain strong secretarial leadership 22
Continue development of department-wide accounting system 23
Enhancing evaluation activities 24
Related GAO Products 26

22TR HOUSING AND URBAN DEVELOPMENT ISSUES
Giving Priority to the Availability and Affordability of Low-Income Housing 4
Retaining private low-income housing 4
Preserving public housing 6
Seeking compatible tax policy 7
Providing benefits through both vouchers and certificates 9
Solving the Homelessness Problem 11
Related GAO Products 13

23TR FOREIGN ECONOMIC ASSISTANCE ISSUES
Role of the Agency for International Development in Critical Policy Areas 4
Managing the AID Program 7
Strengthening Accountability and Control Over Funds 10
Related GAO Products 12

24TR INTERIOR ISSUES
Balancing Competing Demands on Natural and Cultural Resources 4
Overuse and other factors are threatening national parks 4
Overgrazing is damaging public rangelands 6
Hardrock mining policy is damaging public lands 7
Interior lacks vigorous oversight of surface mining 8
Meeting Program Goals and Objectives 10
Cost of deferred park maintenance is approaching $2 billion 10

- About $3 billion more will be needed to reclaim high-priority abandoned coal mines 11
- Archeological surveys will cost billions of dollars 11

Fulfilling Fiduciary Responsibilities 13
- Collection of mineral royalties is uncertain 13
- Proposed Alaska land exchanges are not in the Government's best interest 14
- Water subsidies continue to flow to large farms 17
- Valuable lands are being sold at nominal amounts 18

Related GAO Products 20

25TR TRANSPORTATION ISSUES

Meeting Transportation Challenges Through Strong Secretarial Leadership 4
- Enhancing secretarial leadership in policy-making and program oversight 4
- Reductions in transportation data have hampered the Department 7

Revising the Plan to Modernize the Air Traffic Control System 9
- Plan does not identify all modernization projects and costs 9
- Schedules should reflect past experience 11
- Planning shortfalls and inadequate installation staff could delay modernization 11

Improving FAA's Effectiveness, Whether or Not It Is Independent 13
- Adherence to procurement rules did not cause major delays 13
- Fundamental personnel problems remain to be resolved 14
- Departmental oversight has benefits 16
- Independent or not, FAA will need stable funding 17

Improving Management of Transportation Infrastructure 19
- Needs and costs must be refined and prioritized 19
- Future funding challenges 21
- Technological innovations could help 23

Reassessing the Coast Guard's Role 25
- Need to reevaluate roles and available resources 25

Better management information is needed to support this reevaluation 27
Related GAO Products 29

26TR INTERNAL REVENUE SERVICE ISSUES
Modernizing Information Technology 4
Strengthening Human Resources 7
Improving Collection Activities 10
Closing the Tax Gap 13
Related GAO Products 18

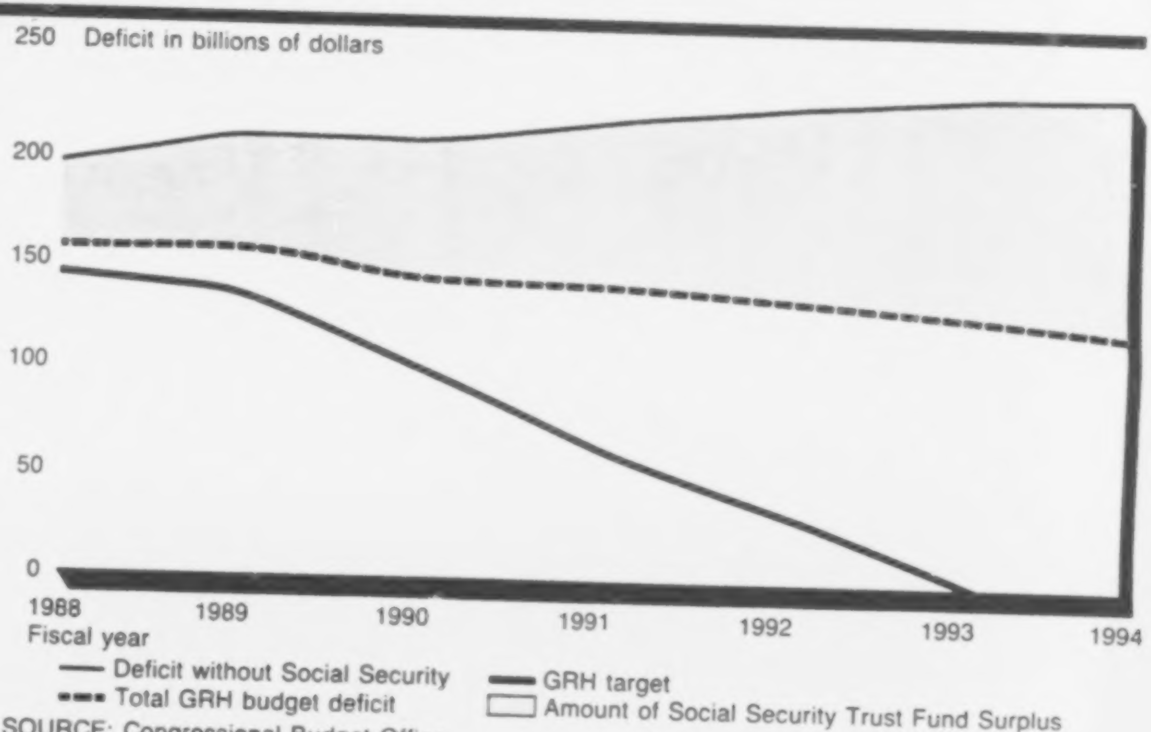
CHART 1

GAO Masking the Federal Deficits With Trust Funds

Billions of dollars	FY 1986	FY 1987	FY 1988	FY 1989	FY 1990
	Actual			Estimates	
Revenues	769	854	909	980	1,064
Outlays	990	1,005	1,064	1,127	1,200
Total deficit	–221	– 150	– 155	– 148	– 136
Federal Funds Deficit	**–283**	**– 223**	**– 253**	**– 264**	**– 263**
Trust fund surpluses: Social Security	17	20	39	52	63
Other trust funds	45	53	58	64	64
Subtotal, TF surpluses	62	73	97	116	127
Total deficit	–221	– 150	– 155	– 148	– 136

CHART 2

GAO Masking the Federal Deficit With Social Security Trust Funds



SOURCE: Congressional Budget Office

CHART 3

GAO Unfunded Costs Facing Government.

Unavoidable costs	
	(Billions)
S&L bailout	$50-100
Nuclear weapons cleanup/modernization	100-150
DOD waste cleanup	10-15
Computer/telecommunications systems update	50-100
DOD weapon systems cost overruns	?
DOD bow wave	?
Unmet needs	
Repair bridges & highways (federal & state)	
Public housing repair	
Retirees' health care	
Prison construction	
Deferred park maintenance	

CHART 4

GAO Restructured Federal Budget for Fiscal Year 1987

Billions of dollars

Components	**Activities** **General**	 **Trusts**	 **Enterprises**	 **Total**
Operating revenues	$573	$326	$59	**$958**
Operating expenses (net)	736	258	60	**1,054**
Operating surplus or deficit	**$ – 163**	**$68**	**$ – 1**	**$ – 96**
Net capital financing requirements	– 58	4	0	**– 54**
Unified total financing requirements	**$ – 221**	**$72**	**$ – 1**	**$ – 150**

United States General Accounting Office

GAO

Transition Series

November 1988

The Budget Deficit

GAO/OCG-89-1TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The President-elect of the United States

One of the most important issues the new President and Congress need to address is reducing the deficit. If we do not get better control over the deficit, it will be exceedingly difficult to implement any new initiatives to deal with the array of needs in the country—be they more money for AIDS research, more money to assure that we have a good air safety system, or more money for needed weapons systems for our armed services.

This report presents an approach for addressing the deficit. Other reports in the transition series discuss specific issues affecting the largest government agencies. They are identified in the back of this report. All of GAO's reports in this transition series are based primarily on detailed reports and testimony already provided to Congress.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Resolve the Budget Deficit 4

Related GAO Products 17

Transition Series 18

Resolve the Budget Deficit

Among the most urgent issues facing your new administration and the new Congress is the budget deficit. Unless this problem is solved—including finding ways to finance the growing list of unavoidable, but so far unfunded, costs—it will hamstring the administration's ability to achieve other vital policy goals; it will make it very difficult to begin addressing the Nation's unmet needs, and it could sap our long-run economic vitality.

There are no quick or painless solutions to the federal government's budget problem. The apparently simple or painless answers will not work.

- We cannot "grow" our way out of the problem. Public demand for government services—to solve problems ranging from drug abuse, AIDS, education, and homelessness to drought and forest fires—grows as fast as revenues, particularly with the potential for "natural" growth of revenues having been greatly reduced with the indexation of the tax code. Projections of a declining budget deficit have misled previous Presidents into believing that budget problems will solve themselves. That picture always evaporated with the passage of time.

- We cannot "freeze" our way out of the problem. Much of the budget is concentrated in politically sensitive entitlement programs, such as Social Security, Medicare, and farm price supports; in the defense program; or in interest costs, which flow directly from the deficit.

- We cannot "sequester" our way out of the problem through mechanistic, formula-based program cuts of the sort prescribed in the Gramm-Rudman-Hollings (GRH) legislation. With between 70 and 80 percent of the budget exempted for a variety of reasons, the rest of the government would be gutted if the machinery were allowed to operate without restraint. The unacceptability of this consequence was demonstrated in 1987, when Congress and the Reagan Administration deferred the GRH targets rather than permit an 8.5- to 10.5-percent sequester. Notwithstanding the rhetoric, the GRH approach has accomplished little more than constraining the growth of the deficit.

- And we cannot reach out and effortlessly gather in some magic pool of uncollected revenues. The results of a tax amnesty program are highly uncertain. Some states have had a favorable experience, but we are skeptical that an amnesty at the federal level would ever yield more than a modest one-time bulge in revenues. More rigorous enforcement of the tax laws has some potential, and we strongly support those efforts, for reasons of fairness in the tax system as well as because of the revenue yield. But hiring and training the thousands of needed revenue agents will take several years. The administrative costs will be large before significant results are seen, and even then the revenue yield will be very modest compared to the problem.

The Situation Is Worse Than It Seems

To compound the difficulty, the budget problem is substantially worse than appears on the surface.

First, the reported deficit understates the real situation. In 1988, for example, the reported deficit of $155 billion actually consisted of a surplus of $97 billion in the trust funds and a deficit in the general funds of $252 billion. The Congressional Budget Office estimates that the general fund deficit will continue to grow, headed toward $300 billion in the early 1990s, but will be masked by the rapidly growing Social Security surpluses.

Second, there is an explosion of unfunded costs waiting to greet the new administration. Some of these are unavoidable.

- The Federal Savings and Loan Insurance Corporation (FSLIC), insurer of about $1 trillion of deposits in the Nation's thrift institutions, is insolvent. There are about 500 insolvent thrifts which are losing money at the rate of almost $17 billion per year. We estimate that it will cost at least another $50 billion to deal with FSLIC's problems, with a significant amount of the money coming from the federal taxpayer.

- The Department of Energy faces the task of cleaning up and modernizing its aging and environmentally hazardous nuclear weapons production complex, involving 50 facilities around the country, some of which have been in use for over 40 years. Serious safety problems that cannot be ignored exist at some facilities. Based on preliminary data, we estimate the cost, over a number of years, of cleanup and modernization at $100 to $130 billion.

- The Department of Defense (DOD) must clean up the hazardous waste pollution that has been identified at over 5,000 sites on military facilities across the Nation. Efforts are underway or planned at less than half these sites. DOD estimates the total program cost at $11 to $14 billion.

In addition, a number of programs are underway whose costs are rapidly escalating far beyond amounts included in the budget forecasts. This will force painful choices of which programs to terminate or curtail and how to finance those that are to be continued.

- The programs included in DOD's most recent 5-year plan will cost at least $200 billion more than is likely to be available even assuming that the defense budget grows 2 percent faster than inflation. There may not be enough money to buy and support all the new weapons systems that DOD has been developing.
- Development of the Strategic Defense Initiative is being funded in 1989 at about $4 billion. DOD has estimated that building the first phase of an operational system will cost $69 billion. Because of the many technical uncertainties, experience suggests that the actual cost will be substantially higher. Some estimates of the cost of a full system range up to $1 trillion or more.
- Several agencies are undertaking badly needed modernization of key computer and telecommunications systems, involving substantial capital investment and operating costs.

—The Internal Revenue Service's Tax System Redesign is expected to cost several billion dollars over the next 10 years.

—An Air Force satellite control system is estimated to cost $48 billion from 1990 to 2015.

—FTS-2000, replacing the government's long distance telephone service, is estimated to cost up to $25 billion over the next 10 years.

—The Department of Veterans Affairs and the Social Security Administration will spend about $1 billion each to modernize key computer systems.

—The Air Force will spend $1.5 to $2 billion to modernize the antiquated computers used to manage over 900,000 items in its supply system.

- The Federal Aviation Administration is 6 years into a program to modernize the Nation's air traffic control system. Originally projected to cost $12 billion, we now estimate the cost will reach $25 billion by the year 2000.
- The National Aeronautics and Space Administration is developing the space station. It will cost an estimated $28 billion

to build and $1.4 billion per year to operate.

There is also a long list of national problems for which there is growing public pressure that the federal government provide a solution.

- Proposals to assist the elderly in financing long-term health care have budgetary price tags ranging from $8 to more than $50 billion per year.
- Suggested tax incentives to encourage companies to fully fund the health care benefits they have promised their retirees could reduce tax revenues by $6 billion.
- The Department of Transportation estimates that it will cost about $50 billion to repair or replace the Nation's 240,000 deficient bridges and that another $315 billion will be needed through the year 2000 to maintain the highways in their 1983 condition. Costs for these items are shared by federal and state governments.
- A study sponsored by the Department of Housing and Urban Development estimates that it will cost about $20 billion to repair the deteriorating stock of public housing. Additional billions may be needed to prevent diversion to other uses of the stock of

privately owned, subsidized low-income housing. No one knows the cost of a serious effort to deal with the problem of up to 3 million homeless Americans.

- In responding to a recent GAO questionnaire, the managers of our National Parks reported a $1.9 billion backlog of deferred maintenance.
- The United States Sentencing Commission has estimated that the federal prison population will be between 78,000 and 125,000 in 10 years. It will cost between $2 and $4.6 billion to build the prisons needed to hold overcrowding to 20 percent above capacity.

Unless the problem of the budget is attacked promptly and aggressively, there will be little money with which to meet these needs or the countless others facing the Nation, ranging from the public health emergency of AIDS and day care for the children of working parents, to improved education, and the diverse environmental problems about which public concern is rising toward panic levels.

Solving the Problem

The budget problem must be solved for the new administration to have any flexibility to pursue its own policy agenda, for the economy to retain its vigor, and for the

American people to enjoy a long-term standard of living comparable to the rest of the developed world. And it can be solved, but not with magic potions, not with smoke and mirrors, not with the traditional techniques of incremental budgeting, and not by perpetuating the confrontations between executive and legislative branches that have typified recent years. The problem can only be solved by hard, good faith political bargaining between the President, the Cabinet, and the Congress.

The foundation for a realistic approach to solving the budget problem is recognition of the following:

1. Continuing budget deficits are a crisis; the crisis warrants the commitment and bipartisan spirit of compromise in the national interest that our political system traditionally brings to a crisis situation.

2. The problem cannot be solved by the President alone, nor by the Congress alone, but only through the combined efforts of both branches of government.

3. The problem cannot be solved in 1 year, but requires a carefully developed, politically sustainable, multiyear budget strategy.

With this foundation, the first step must be for the President to open negotiations with the bipartisan leadership of both houses of Congress in an effort to develop consensus on a meaningful budget strategy. For the negotiations to succeed, certain elements are key.

1. All participants must consider all parts of the budget to be negotiable, including defense, entitlements, and revenues.

2. The pace at which the deficit is to be reduced can be negotiable, but only within reasonable limits. The goal must be to reduce the deficits in the general fund and to move toward approximate balance or surplus in the unified budget at a steady, sustainable pace.

3. The agreement on strategy must be sufficiently specific to be meaningful, but flexible enough to allow for changing conditions. An appropriate goal would be an agreement structured along the lines of a congressional budget resolution and extending for 5 years.

4. The negotiations must work with realistic estimates of costs—including recognition of known budget threats—and with credible economic forecasts.

5. The Federal Reserve chairman should be asked to participate—at least as an observer—because of the importance for the economy of carefully adjusting monetary policy as progress is made on the deficit.

Achieving Consensus

Experience has demonstrated that in certain policy areas agreement on budget numbers will unravel quickly unless there is also agreement on how the numbers will be achieved.

1. In defense, it is already evident that the budget cannot finance all the weapons systems now being developed while also maintaining the present force structure with adequate readiness and sustainability. The Department of Defense's planning has not yet adjusted to the implications of this new reality, which will produce dangerous imbalances and inefficiencies unless carefully managed. These adjustments need to be accompanied by a thorough reexamination of our international commitments and our defense goals, strategies, and force structures.

2. In negotiating spending levels for entitlement programs, attention must be given to the implications for the trust funds. If cost-of-living adjustments are restrained, for example, the Social Security trust fund

surpluses will grow at an even more rapid pace. While this will help reduce the overall deficit, the negotiations must also address the sensitive issue of how these additional "reserves" will be used.

The reserves, of course, are only entries on the books at Treasury. When they are needed to pay benefits to retirees, the cash will have to come from tax revenues or more borrowing.

3. Additional revenues are probably an unavoidable part of any realistic strategy for reducing the deficit. In negotiating this element, it is essential that the agreement cover not just the amounts of revenue to be raised but also:

- the specific sources (income, payroll, consumption, or excise taxes, or specific user fees);
- the legislative schedule for enactment of the required statutory changes;
- a realistic schedule for implementing the new laws; and
- the administrative resources needed to collect the additional revenues.

Negotiating a strategic agreement on budget policy will be an arduous task. Substantial personal involvement by the President will be essential, both because of the stature he brings to the process and because of the need to make tradeoffs among competing political objectives of the administration.

The Nation is at a crossroads in dealing with the budget deficit. If the President and Congress promptly seize the initiative and successfully negotiate a new consensus on budget policy, they can put the Nation on the path to continued growth and to sustainable domestic and international financial relationships. If they procrastinate or fail, the Nation's economic future will be at risk and the administration's ability to achieve other policy objectives will be imperiled by a lack of resources and a continued atmosphere of confrontation with Congress.

Related GAO Products

Comptroller General's Letter to Drew Lewis and Robert Strauss, Co-Chairmen, National Economic Commission, (Aug. 3, 1988)

Improving Government Management and Accountability (GAO/T-AFMD-87-1, Feb. 18, 1987)

Budget Issues: Capital Budgeting for the Federal Government (GAO/AFMD-88-44, July 1988)

Budget Reform for the Federal Government (GAO/T-AFMD-88-13, June 7, 1988)

Managing the Cost of Government: Building an Effective Financial Management Structure (GAO/AFMD-85-35, Feb. 1985)

Defense Budget and Program Issues, Fiscal Year 1989 Budget (GAO/T-NSIAD-88-18, Mar. 14, 1988)

Nuclear Health and Safety: Dealing With Problems in the Nuclear Defense Complex Expected to Cost Over $100 Billion (GAO/RCED-88-197BR, July 6, 1988)

Deficit Reductions for Fiscal Year 1989: Compliance With the Balanced Budget and Emergency Deficit Control Act of 1985 (GAO/AFMD-89-32, Nov. 15, 1988)

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

United States General Accounting Office

GAO

Transition Series

November 1988

The Public Service

GAO/OCG-89-2TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The President-elect of the United States

This second transition series report addresses an issue that is not as visible as most but maybe more important—the need to assure that the government has top-quality people to carry out the programs of the President and Congress and hold them accountable for achieving results. The laws, regulations, and processes of government are only as good as the people who have to carry them out. All too often we have not paid enough attention to these critical factors—quality people and accountability—needed to assure successful implementation of government programs.

The issues discussed in this summary report are based primarily on reports and testimony already provided to Congress.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Improve the Public Service 4

Related GAO Products 13

Transition Series 14

Improve the Public Service

Reestablishing the integrity and credibility of government against the backdrop of budget deficits, limited resources, demands for new programs and initiatives, and critical national and international crises that are bound to develop will not be easy.

To a large extent, the government today is faced with a "people problem." How can the federal government attract, motivate, and retain committed people—people at all levels who can come up with new ideas and innovative approaches and see them through to effective implementation?

Image Building

Concern is mounting that the government's ability to acquire and retain good people is diminishing. There are major risks associated with this situation.

If the quality of the federal workforce is reduced, the quality of government services and programs is reduced. The bottom line in this situation is not less profit, but, more importantly, less effective government services—services that touch the lives of literally millions of people—and, therefore, less respect for the government. Sophisticated systems and controls are only as good as the people who must carry them out.

In 1987, more than 500 federal employees, at all levels, were convicted of criminal offenses related to their jobs. With a workforce of about 3 million, the 500 is minuscule. But numbers are misleading. When such offenses occur, especially among higher level officials, respect for and confidence in the government diminishes.

Theodore Roosevelt talked of using the presidency as a "bully pulpit." Today, this kind of leadership is needed to invigorate the public service.

After years of "fed-bashing" the new President needs to change course. In 1987 governmentwide surveys, many federal managers reported lower motivation levels. Personnel officers said that the negative image of public service was a significant barrier to attracting needed staff. Only 13 percent of senior executives said they would advise people beginning their careers to enter public service.

Addressing Pay Problems

You get what you pay for. Unfortunately, the federal government's pay structure has broken down.

The White House Science Council, the President's Blue Ribbon Commission on

Defense Management, and his Commissions on Compensation of Career Federal Executives and on Federal Pay have all concluded that the inadequacy of federal compensation seriously affects the government's ability to attract and retain a high-quality workforce. According to a recent report—Civil Service 2000—done for the Office of Personnel Management, this problem is expected to worsen over the next decade.

What has been the result of the breakdown of the pay system? Some examples follow:

- Over half of all federal personnel officers we surveyed in 1987 said that their ability to hire competitively over the last 5 years has worsened.
- The Federal Aviation Administration, Internal Revenue Service (IRS), and Social Security Administration (SSA) had substantial difficulty attracting or retaining flight controllers, revenue agents, and computer specialists.
- Over half of the government's senior career executives we recently surveyed said they would likely accept a desirable position outside the federal government if one became available.

Changing the situation will take time, but the foundation for improving the public service must recognize the following:

1. The morale and credibility of the federal workforce can be greatly improved if the President himself uses public forums to express his support for high-quality public servants.

2. Political appointees must adhere to high ethical standards and make ethics in government a priority in their agencies.

3. The pay and benefit structure for political and career employees needs to be changed. We cannot continue to expect to make progress in this area by saying that all solutions must be "budget neutral" and that agencies must continually absorb the costs of all pay and benefit increases.

Achieving Accountability

Even with the above improvements, however, successful development and implementation of government policies and programs is not a sure thing.

A strong force mitigating against success has been the continued excessively adversarial relationship between the executive branch and Congress. Conflict and debate are inherent in our political system. But there needs to be a better consensus on what is important and what we are trying to achieve.

Contributing to the problems is the lack of continuity and consistency of leadership in executive departments and agencies. Changing gears and direction every 18 to 24 months at agencies contributes to ineffective management.

- Rapid turnover of leadership, resulting in several changes in direction, and insufficient technical leadership and staff were seriously impairing SSA's and IRS' efforts to modernize their computer systems. This has adversely affected the cost, accuracy, and timeliness of SSA's and IRS' service to the public and could have even greater impact in the future if modernization progress does not improve.
- High turnover, inadequate training, lack of career paths, and questionable ethical conduct among some officials and staff involved in the defense procurement system have contributed to cost overruns, flawed competition and negotiations, and negative public perceptions concerning the weapons acquisition function.
- The lack of strong central leadership has been a major factor behind the limited

progress being made in the government's war against drugs.

Congress is too often faced with dealing with new people from the executive agencies who have to spend too much time learning on the job.

What can be done? We can't expect all political appointees to commit to specific terms of office—that may not even be desirable. But we can expect a more coherent approach to development of goals and how to achieve them.

The lack of measurable goals and objectives makes it difficult to know whether important programs and initiatives are succeeding. Lack of a consensus on how to judge success tends to exacerbate political differences. Rather than focusing on ways to improve situations, too much effort is spent defending or attacking positions.

- Transportation safety is a major concern and improved safety has been a major transportation goal. While the overall number of deaths from transportation accidents has declined, accidents and fatalities continue to be a matter of serious concern in all modes. Further, near mid-air collisions between aircraft and high-risk incidents in the other modes continue at alarming rates. Transportation needs to build on efforts already underway in the aviation area to develop early warning indicators of safety risk and modal performance, and this effort should be extended to the other modes. These indicators could be used to identify and remedy unsafe conditions before accidents occur and provide a measure of whether important safety programs and initiatives are succeeding.

- Over the years, the government has devoted substantial resources to control the supply of drugs. We have increased spending on drug interdiction activities by almost 1,500 percent from 1977 to 1987. Yet drugs are still widely available today. It is time to reassess federal drug abuse control strategy. Further primary emphasis on supply reduction programs will probably not solve our country's drug problem. More resources need to be assigned to demand reduction activities.
- The Nation has spent over $500 billion to deal with a host of environmental problems. The Environmental Protection Agency is trying to manage for results. But there are no specific, measurable operational objectives to gauge our progress. Congress and EPA have not always agreed

on environmental priorities and what is needed to meet legislative mandates.

- For years administrations have been trying to improve the Defense Department's major weapons acquisition function. Commissions have called for the need to establish clear authority for acquisition policy, clear accountability for acquisition execution, and plain lines of command for those with program management responsibilities. Defense keeps trying to implement such recommendations but how do we decide whether we are succeeding?

There are potential political risks in identifying objectives and agreeing to be held accountable for meeting them. Many factors beyond the control of any individual official or group of officials can affect outcomes. But does that mean we should not try? We believe it is important to begin the effort. A more collaborative process between the President, his agency heads, and Congress for identifying a manageable number of priorities and objectives and then assessing progress towards those ends can reduce the political risks for everyone.

The politics of governing is not always glamorous. It requires paying attention to who is going to do the jobs of government and knowing when they are succeeding. But if we pay more attention to these factors, program success is more likely to occur.

Related GAO Products

Comptroller General's Letter to Paul A. Volcker, Chairman, National Commission on the Public Service (Jan. 14, 1988)

Senior Executive Service: Executives' Perspectives on Their Federal Service (GAO/GGD-88-109FS, Jul. 20, 1988)

The 1988 Tax Return Filing Season and IRS' Fiscal Year 1989 Budget (GAO/T-GGD-88-30, Apr. 13, 1988)

FAA's Air Traffic Controller Staffing Standards (GAO/T-RCED-88-8, Nov. 18, 1987)

Superfund: Improvements Needed in Workforce Management (GAO/RCED-88-1, Oct. 26, 1987)

Federal Employees: Trends in Career and Noncareer Employee Appointments in the Executive Branch (GAO/GGD-87-96FS, Jul. 8, 1987)

Social Security Administration: Stable Leadership and Better Management Needed to Improve Effectiveness (GAO/HRD-87-39, Mar. 18, 1987)

Managing IRS: Actions Needed to Assure Quality Service in the Future (GAO/GGD-89-1, Oct. 14, 1988)

Federal Workforce: Pay, Recruitment, and Retention of Federal Employees (GAO/GGD-87-37, Feb. 10, 1987)

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

United States General Accounting Office

GAO

Transition Series

November 1988

Revenue Options

GAO/OCG-89-3TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Secretary-designate of the Treasury

This report is one of a series addressing major policy issues facing the next Congress and administration. The first in the series deals with what many consider the most important issue that must be addressed—the deficit.

This report describes the key points raised in our recent work, and in the work of others, concerning certain revenue options frequently proposed: raising income tax rates, broadening the income tax base, enacting a consumption tax, increasing revenue from federal excise taxes, and strengthening IRS enforcement. A combination of these options could emerge because each option alone has some drawbacks.

Based on past experience it will be extremely difficult to bring down the deficit solely through management efficiencies and spending cuts. Many people, including those involved in our domestic and overseas financial markets and institutions, would not view any deficit reduction effort as credible without some revenue increases. Therefore, the Congress and the administration must carefully consider the advantages and disadvantages of various revenue options available to deal with the deficit.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Raise Income Tax Rates 4

Broaden the Income Tax Base 6

Enact a New Consumption Tax 11

Increase Revenue From Federal Excise Taxes 16

Increase Internal Revenue Service Enforcement 20

Increase Non-Tax Revenue Sources 22

Related GAO Products 25

Transition Series 27

Raise Income Tax Rates

At first glance, raising income tax rates appears to be the least complicated way to raise additional revenues. A small rate increase would generate a significant amount of revenue. IRS would not have to change any of its current administrative procedures and Treasury would begin to receive the additional revenue relatively quickly, as soon as the adjustment could be made to withholdings and estimated tax schedules.

Revenue Gains Are Potentially Large

Tax rates could be raised in various ways. Experts have estimated that a single percentage point increase in the two individual tax rates and the corporate rate would increase revenues by about $30 billion annually. The Congressional Budget Office (CBO) estimated that an increase in the lower individual tax rate from 15 to 16 percent and the upper statutory rate from 28 to 30 percent would raise revenues by about $30 billion per year. CBO also estimated that a 5-percent surtax applied to tax liability after credits would raise almost $23 billion annually.

But Many Are Reluctant to Raise Rates After Tax Reform

Even though increasing income tax rates would be technically simple, many Members of Congress believe that they have a tacit agreement with the public, through the Tax Reform Act of 1986, not to raise tax rates. This act represents the most significant change in federal tax policy during the postwar era. It lowered the rates, broadened the base, and removed many of the Nation's poor from the tax rolls. But lowering the rates, which improved incentives to work and save, is viewed as the quid pro quo for the base broadeners in the act. Also, raising the rates might rekindle the debate over preferential treatment of income from capital gains. If this were to occur, there is a possibility that several of the reforms achieved in the act would begin to unravel.

Broaden the Income Tax Base

While the Tax Reform Act of 1986 significantly broadened the tax base, close to $300 billion in tax expenditures, over 120 separate tax preference items, still remain in the tax laws. Most of these preferences were originally justified as fostering some socially desirable goal, such as improving equity or reducing burdens on a particular activity, like owning a home. But the proliferation of tax expenditures has been criticized because they complicate the tax laws and are frequently less efficient than direct expenditures.

A small number of the 120 items comprise a relatively large share of total tax expenditures. The largest tax expenditure is in the area of employer-provided fringe benefits (e.g., pension contributions, health insurance). Deductions for mortgage interest payments and state and local taxes rank second and third. Other significant tax expenditures are in the areas of accelerated depreciation, nontaxed capital gains, tax-exempt bonds, nontaxable social security benefits, charitable contributions, and various types of individual retirement accounts.

Each Tax Preference Item Has Strong Backing

Each tax preference has a strong vested interest group arguing for continuation or expansion of its particular preference. For example, most retirees would be affected if Social Security benefits were taxed in the same way other pension programs are taxed. Moreover, any revenue increase from such an option would not help reduce the federal funds deficit unless Congress reconsidered its decision to place the proceeds from any taxation of Social Security benefits into the Social Security trust fund.

Two other examples in the areas of tax-exempt bonds and insurance further illustrate the support for tax preferences. The National Council of State Housing Agencies and the Association of Local Housing Finance Agencies have lobbied aggressively on behalf of tax-exempt mortgage revenue bonds. They have urged that state and local government issuance authority for these bonds be extended beyond their expiration date. The insurance industry has given strong backing to a preference item that excludes taxation of investment income earned by life insurance policyholders. We have issued reports on these two items and Congress deliberated this year whether to restrict or eliminate these tax expenditures in the technical corrections tax bill.

But Some Tax Preferences Could Be Made Less Costly Through Narrower Targeting

We have argued that the 1989 estimated tax expenditure of $1.7 billion for all outstanding mortgage-revenue bonds is costly and not well-targeted to the intended beneficiaries, low- and moderate-income home owners. Congress in the Technical Corrections Act of 1988 voted to extend bond issuance authority but placed greater targeting restrictions on bond-financed mortgages. The Joint Committee on Taxation estimated these restrictions would result in a 60-percent savings on new bond issues over what the tax expenditure would have been if issuance authority were extended without restrictions. In dollar terms this represents an average reduction in tax expenditure of almost $50 million annually for the next 3 years.

Single premium life insurance policies provide a device for capturing investment income without reflecting it on an income tax return. In a recent report, we recommended that this preference item be restricted and presented two alternatives to change the tax status of single premium life insurance products. Congress voted to somewhat restrict this tax expenditure, raising about $100 million annually.

Two other examples of tax preferences that could be more narrowly targeted are the mortgage interest deduction and the state and local tax deductions. The mortgage interest deduction is a tax expenditure valued at over $30 billion per year. While it may not be possible to repeal the deduction, it may be possible to narrow the target group.

Under the current mortgage interest deduction cap, a taxpayer may not deduct interest on "acquisition debt" over $1 million and "equity debt" over $100,000. If the overall debt on a principal and second home exceeds $1.1 million, interest on the excess debt becomes personal interest and is only partially deductible. It may be possible to lower this cap or lower the value of the deduction by some amount. To illustrate the revenue potential of this approach, CBO estimated that, if the value of the deduction were limited to the lowest marginal tax rate, currently 15 percent, nearly $12 billion more could be raised per year.

Similarly, it may be possible to narrow the target group that benefits from the deduction for state and local taxes. This deduction reduces federal tax liability for itemizers only and the value of the deduction is worth more to taxpayers in higher brackets. To illustrate the revenue potential associated with this approach, CBO estimated that revenues would increase by almost $5 billion annually if the deduction were restricted by a ceiling of 7.5 percent of adjusted gross income (AGI). In other words, a taxpayer would not be able to deduct state and local taxes above 7.5 percent of AGI. CBO also estimated that completely eliminating state and local tax deductions would raise over $25 billion per year in revenues.

Enact a New Consumption Tax

A consumption tax is levied on a taxpayer's expenditures for goods and services rather than on a person's or firm's income. Hence, saving is not taxed. There are generally three types of broad-based consumption taxes: (1) a personal expenditure tax, (2) a national retail sales tax, and (3) a value-added tax (VAT).

Under a personal expenditure tax, which would replace the individual income tax, individuals would pay tax only on their consumption. Withholding would continue and individuals would be required to file an annual form with IRS similar to the form filed for income tax purposes.

The other two types of consumption tax could be added to the current income tax system. Under a national retail sales tax, the compliance burden to file the appropriate form and pay the collected tax would be placed on retail businesses. A VAT, on the other hand, would not be collected solely at the retail stage of the production process. Instead, a VAT would distribute the tax collection burden across various stages of production. Of the three consumption tax options, the VAT is discussed most frequently, in part because it is used by most other industrialized nations.

The Potential for Revenue Gains Would Be Substantial

Interest in the VAT has grown considerably in recent years. If substantial sums are needed to close the deficit, the VAT offers that potential at a reasonably low rate. CBO estimated that a comprehensive 5-percent VAT could bring in almost $117 billion annually, while one that exempted food, housing, and medical care could yield about $67 billion annually.

How the Value Added Tax Works

The VAT, a multistage tax, can best be seen as a particular means of collecting a general sales tax on consumer goods and services. Tax is collected at each stage in the production-distribution process on the value that firms add to goods and services bought from suppliers. We are currently reviewing two different methods of collecting a VAT—the subtraction method and the tax-credit or invoice method.

The two methods differ in the information used to calculate tax liability and in their ability to accommodate various design features that have direct tax policy implications. Under the subtraction method the statutory tax rate is applied directly to the firm's value added, which is calculated by subtracting purchased inputs from sales. The subtraction VAT does not require the taxpayer to keep additional records, but the tax rate must be uniform because the taxpayer does not calculate the tax on each separate transaction.

Under the tax-credit method, the firm must first calculate its gross tax liability by applying the statutory rate to its sales, then calculate its net liability by deducting the amount of tax it has paid on its purchases. This method requires a separate invoice for each transaction, placing additional record-keeping burden on some taxpayers. But separate invoices allow greater flexibility in the design of a VAT. The policymaker can, for example, reduce the VAT's regressivity by creating different tax rates for luxuries and for necessities, such as food or medicine.

Would a VAT Improve Our Domestic and International Economic Position?

Advocates believe that an increase in federal revenues through a VAT would have less of an adverse effect on long-run economic growth, investment, and savings than a similar-sized revenue increase using the income tax. They also believe that a VAT, if substituted for a corporate income tax, would improve our international competitive position by increasing corporate profit, reducing the cost of capital, and improving our balance of trade. Other experts, however, doubt that balance of trade improvements could be maintained because adjustments to currency exchange rates would nullify any initial improvements.

One additional aspect often mentioned by VAT proponents is that a VAT would help harmonize the U.S. tax structure with many of its trading partners. While the European Economic Community uses a VAT that taxes imports but not exports, two of our major trading partners, Japan and Canada, currently do not impose a VAT. However, both countries are considering consumption tax proposals of the VAT or national sales tax variety. If they both enact a VAT, the U.S. will be one of the few major industrialized nations in the world without a VAT.

Basic Concerns in Designing a VAT

The regressivity issue is one major concern in designing a VAT. Without any adjustment for taxes paid, a VAT would cause low-income persons to incur substantial tax liabilities, paying a higher percentage of their income in this tax than those earning higher incomes.

Because the revenue estimates are so large, another concern is that a VAT could become a "money machine" encouraging more, rather than less, government spending. Some restrictions on rate increases would have to be part of the design before those who worry about the "money machine" problem would support a VAT. Critics of a VAT also worry about an adverse effect on the inflation rate and federal intrusion into a revenue base that has traditionally belonged to state and local governments. We are currently doing a study on this latter concern.

What Would It Cost to Administer a VAT?

Due to lack of U.S. experience with a VAT, much of the empirical evidence and analyses necessary to make fully informed decisions on the administration of this type of tax in the United States does not exist. To assist Congress in debating this issue and to be prepared to implement such a tax, were it to pass, IRS needs to study how it would implement various types of VATs and reevaluate the costs associated with administering them.

In the only published evaluation, made in 1984, IRS estimated that it would need at least 18 months after enactment before it could begin to administer a VAT. It also estimated that a VAT, when fully phased in, would cost about $700 million per year to administer and require about 20,000 additional employees. However, these estimates were based on a set of broad assumptions. For example, IRS assumed that all firms would be subject to a VAT. The estimates could vary substantially under different assumptions.

Increase Revenue From Federal Excise Taxes

The federal government currently imposes over 100 excise taxes on various goods and services. While accounting for a small share of revenues, an estimated $35.3 billion or 3.9 percent in 1988, these taxes are receiving increased attention as a means of reducing the federal deficit.

An argument for increased reliance on these taxes is that the cost of consuming many of these items spills over onto society as a whole. For example, the full cost of smoking includes the smoke-related medical costs borne by both smokers and nonsmokers. However, excise taxes are criticized as being generally regressive, resulting in increases that could offset the gains in equity achieved by tax reform when many of the poor experienced substantial reductions in their taxes.

A package of all the various options to raise revenues through excise taxes could not be put together without substantial effort. A Brookings tax expert estimated that "with an heroic effort, Congress might increase excise taxes by perhaps $30 billion." But to achieve such an increase would entail almost doubling current excise tax revenue, which we think would be very difficult.

Restore Erosion From Inflation

We are currently studying how past inflation has eroded the potential revenue that could have been realized from various excise taxes that are imposed in per unit terms rather than per dollar value of the respective product. Taxes on beer, wine, certain tobacco products, and certain weapons have been imposed at their current rate for over 30 years. Since 1965, the last time Congress undertook a comprehensive examination of excise tax rates, the Producer Price Index has risen by almost 220 percent. If excise tax rates on the above items, in addition to the tax on distilled spirits and occupational wagering, had been indexed since 1965, they would have at least doubled, producing substantially more annual revenue.

Raise the Rates or Equalize Them Among Similar Products

The current federal tax on gasoline is 9.1 cents per gallon; the tax on diesel fuel is 15.1 cents per gallon. Some observers argue that the tax is not adequate to encourage conservation and it is too low relative to what Europeans pay. They also argue that people who use the roads or buy goods shipped by road cause "negative externalities"—pollution, congestion, and noise—and should pay for them. To illustrate the revenue potential, CBO estimated that, if these tax rates were raised an additional 12 cents per gallon, revenues would increase by about $11 billion annually. However, motor fuel tax revenues and revenues from certain other excise taxes are earmarked to trust funds. If Congress wants to reduce the deficit with additional revenues from earmarked taxes, it will have to allocate those revenues to the general fund.

Some excise taxes have been criticized because the tax rates on similar products are not equal. The tax rates on beer and wine are much lower than the tax rate on liquor when computed by alcoholic content—about a penny per ounce of alcohol in wine, a nickel in beer, and a dime in whiskey. CBO estimated that increasing rates to the alcohol-equivalent rate on distilled spirits would raise roughly $4 billion per year.

Broaden the Base

The excise tax base could also be broadened by eliminating exemptions on certain goods and services. In our review of excise taxes we found that current law taxes some types of gambling activity while exempting other types such as state-licensed parimutuel wagering, most tax-exempt organization activities, and activities that require winners to be present. For example, bingo, keno, and casino gambling are generally exempt.

Enact New Excise Taxes

Another revenue option would be to enact new excise taxes. Congress recently enacted new excise taxes on certain fishing equipment—electric outboard motors and sonar fish finders. But it is not easy to impose a tax on a commodity or service that is no longer taxed or was not previously taxed. For example, last year Congress considered a proposal to tax transactions on the stock market. This proposal, called a stock transfer tax, met stiff opposition. This opposition argued that the tax would result in lower share prices and lower trading volume, thus reducing the efficiency of the market. A similar but more recent proposal is a tax on financial transactions that would have a low rate but a very large base.

Increase Internal Revenue Service Enforcement

Several actions, summarized below, are also discussed in our transition series report on IRS (GAO/OCG-89-26TR).

Reduce the Tax Gap

IRS estimates individuals and corporations will not pay $87.1 billion in income taxes owed the government for 1988 and that this amount will grow to $113.7 billion by 1992. The 1988 estimate of the tax gap consists of $64.3 billion in unpaid income taxes by individuals and $22.8 billion unpaid by corporations. The tax gap estimates show that unpaid taxes remain substantial and that IRS can more vigorously seek to collect specific pockets of unpaid taxes through enforcement programs.

Increase Examination Resources

IRS figures show that it audited 2.29 percent of taxpayer returns 10 years ago; by 1987 that figure dropped to 1.1 percent. With more examination resources IRS could expand audit coverage and generate additional tax revenue from taxpayers who have overstated deductions or understated income. This revenue, however, would not be realized immediately because of the time it takes to recruit and train new revenue agents. CBO estimated that an additional 3,302 staff positions in examinations would yield between $0 and $160 million in the first year and $588 million the first fiscal year in which all new hires were employed for the complete year.

Improve Collection Activities

In addition to tax gap estimates, IRS recently reported a total accounts receivable balance of about $56 billion. Such taxes owed the federal government have grown at a steady pace and we expect the trend to continue. IRS' Internal Audit Division estimated that about $33 billion of the balance is collectible, but IRS has little detailed information on how much of the accounts receivable inventory can be collected and does not know what collection tools are most effective. As a result, IRS has not been able to effectively reduce the growth of accounts receivable and collect delinquent taxes, thus depriving the government of a significant source of revenue to reduce the budget deficit.

Increase Non-Tax Revenue Sources

Increase Reliance on User Charges

It is appropriate to explore opportunities to expand and improve the application of user charges. When federal agencies provide goods, services, and privileges that benefit identifiable recipients, charging recipients for these benefits deserves consideration. Charging for the benefits from these publicly provided goods is equitable because it assures that costs are directly borne by the beneficiaries, rather than taxpayers in general. Also, charging is efficient because it helps to better allocate scarce government resources.

However, some prices could be set below full government expenses to account for external costs or to permit access by those with low incomes. There is a need for an overall review of current federal user charge policies. The user charge option could be regularly considered in designing future federal programs, even though revenues gained from user charges may not be significant relative to the deficit.

Selling Federal Assets

In January 1986, the administration initiated a proposal to improve federal credit management and to generate budgetary receipts through the sale of $4.4 billion in loan assets. This initiative expanded to $6.8 billion of sales in the 1986 Budget Reconciliation Act, and to $12.6 billion in the President's fiscal year 1988 budget.

We found, however, that the government had to provide credit enhancements—indemnification to private investors against loan losses after the sale—for it to maximize net sale proceeds. Sales without recourse would have significantly lowered the price received. Thus, investors who purchased these loans did not assume the full risk of loss, as OMB had initially required. Also, we found these sales simply shift future cash receipts to the budget year in which the sales are completed.

An overall decrease in the structural budget deficit would occur only if the proceeds from a loan sale or prepayment were more than the present value of foregone loan principal and interest payments. This did not occur in the loan sales we analyzed. Thus, we believe a change in budgetary accounting for loan programs and loan sales should be made to more properly reflect the true nature of loan programs and sales.

Gains Through Economic Growth

Although not directly controlled by policymakers, economic growth can result in significant increases in federal receipts. One Brookings economist estimated that federal individual income tax receipts would increase by 1.5 percent for every 1.0 percent increase in adjusted personal income, under 1988 tax rates. In other words, an additional 1 percent or about $34 billion in 1988 personal income would result in an additional 1.5 percent or $6.1 billion in individual income tax revenue.

Related GAO Products

The Congress Should Consider Exploring Opportunities to Expand and Improve the Application of User Charges by Federal Agencies (GAO/PAD-80-25, Mar. 28, 1980).

Tax Policy: Choosing Among Consumption Taxes (GAO/GGD-86-91, Aug. 1986).

Tax Policy: Taxation of Single Premium Life Insurance (GAO/GGD-88-9BR, Oct. 16, 1987). Testimony given on March 15, 1988, before the Subcommittee on Select Revenue Measures, Committee on Ways and Means, House of Representatives.

Loan Asset Sales: An Assessment of Selected Sales (GAO/AFMD-88-24, Feb. 19, 1988).

Home Ownership: Mortgage Bonds are Costly and Provide Little Assistance to Those in Need (GAO/RCED-88-111, Mar. 28, 1988).

The Budget Crisis: Hard Choices in the Real World. Excerpted from a presentation by the Comptroller General before the annual meeting of the National Association of State Comptrollers, May 18, 1988.

Tax Administration: Difficulties in Accurately Estimating Tax Examination Yield (GAO/GGD-88-119, Aug. 8, 1988).

Internal Revenue Service Issues (GAO/OCG-89-26TR).

Tax Policy: Subtraction VAT vs. Tax Credit VAT (forthcoming).

Tax Policy: The Potential for Increasing Federal Excise Taxes to Enhance Revenue (forthcoming).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

United States General Accounting Office

GAO

Transition Series

November 1988

Financial Services Industry Issues

GAO/OCG-89-4TR

GAO United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Secretary-designate of the Treasury

This summary report is one in a series that addresses major policy, management, or program issues facing Congress and the new administration. The discussion of issues, the problems associated with each, and recommended actions are based on our work in the financial services industry area. Some of our concerns are relatively new, while others represent unresolved problems that have been developing over the past several years.

This report identifies four important issues we believe should be included in whatever agenda Congress and the Secretary of the Treasury, as well as the heads of banking, thrift, securities, and futures regulatory agencies set for considering our Nation's financial services industry. They are (1) handling troubled financial institutions, (2) regulating the merging of banking and nonbanking lines of business, (3) regulating linked securities and futures markets, and (4) regulating global capital markets.

These issues are discussed in detail in the reports and testimonies listed at the end of this report.

Charles A. Bowsher

Charles A. Bowsher

Contents

The Financial Services Industry 3

Reestablishing Financial Stability in the Thrift Industry 5

Managing the Deregulation of Banks 9

Regulating Linked U.S. Financial Markets 12

Regulating Globally Linked Markets 15

Related GAO Products 19

Transition Series 21

The Financial Services Industry

The Nation's financial institutions and markets are in a state of turmoil. Not since the early 1930s have they faced the multiplicity of challenges they face today. Depository institutions, particularly savings and loans, are becoming insolvent or suffering problems in numbers that set post-Depression records. At the same time, in spite of laws and regulations that separate commercial banking from other lines of business, financial services firms are finding ways to combine those activities. The issue now is how best to redraw the industry structure.

Our linked securities and futures markets face new demands created by new market strategies and trading technologies, as well as products that are poorly understood and viewed with deep suspicion by even seasoned market experts. The October 1987 stock crash bared these weaknesses and also revealed how quickly financial conditions can deteriorate in emergencies. Finally, our financial markets now function in a global arena in which the competitive stakes are high and crises can spread around the world almost instantly.

The new administration must respond to these separate but closely related challenges. In so doing, it will shape the future of the industry—for better or for worse—for decades to come.

Reestablishing Financial Stability in the Thrift Industry

In the wake of poorly implemented deregulation, mismanagement, and depressed regional economies, almost a third of the savings and loan industry is insolvent or nearly so; less than $4 billion of tangible capital backs $1.3 trillion of customer deposits; and the Federal Savings and Loan Insurance Corporation (FSLIC) is insolvent by $14 billion. The administration must decide

- how to finance the $50 billion or more that may be needed to restore financial stability and thereby prevent panic and collapse, and
- what regulatory controls are needed to prevent a repetition of today's problems.

Solving the problems of the thrift industry will entail a monumental drain on the depository industry and federal resources. In recent years, regulators and Congress have resisted massive closings of insolvent institutions in the hope that the institutions could pull themselves out of the hole. But this strategy of forebearance has failed. For the most part, it simply delayed the inevitable while adding to the eventual costs.

The time has come to move as quickly as possible to close insolvent institutions.

That means fully recognizing and finding the money to pay for the losses in those institutions—money that FSLIC does not have today. In this regard, we see the following possibilities:

- While the self-insured system we have had for the last 50 years suggests that the thrift industry should contribute to the solution, the problem is too large and the industry is too weak to solve the problem alone.
- While merging FSLIC with the healthier Federal Deposit Insurance Corporation (FDIC) has been suggested as a possibility, it would not solve the financial problems. The FDIC's reserves cannot cover the FSLIC losses. Moreover, problems in the commercial banks, especially those related to energy, real estate, agricultural, and third world lending, may require all of FDIC's present $18 billion of reserves.
- In the final analysis, those who have created the problem, those who have benefitted from the problem, and those who will benefit in the future should share in funding the solution. Sharing of costs should be based on the principles that (1) funds contributed by the thrift industry should not significantly weaken healthy institutions, (2) funds raised from other depositories

should not adversely affect their competitive position, and (3) funds provided by the insured depositing public, whether through use of general revenues or a more explicit user charge, are needed to make up for the shortfall in the costs that they have paid for deposit insurance protection.

Resolving today's problems, however, will be futile if they are repeated tomorrow. Without some fundamental changes to the way the depository industry, particularly the thrift industry, is regulated, there is little to prevent a reoccurrence. Avoiding that will require:

- Strengthening the capital base of the industry and quickly and efficiently closing institutions that fail.
- Improving oversight and supervision to control risk-taking.
- Experimenting with incentives for insured institutions to control their own risk taking by giving them the option of operating under one of two deposit insurance mechanisms. Under one, premiums or capital levels based on risks would be paid to the deposit insurer for its risk bearing. Under the other, involving collateralization of deposits or significant limitations on the uses made of deposits, institutions would

internalize the costs of their risk bearing and only nominal premiums would be paid to the deposit insurer.

- Establishing firm guidelines for quickly and efficiently dealing with problem institutions, including enhancing the ability to withdraw insurance protection.
- Reconsidering the wisdom of the regulatory distinctions between thrift institutions and commercial banks. The schizophrenic position of the Federal Home Loan Bank Board as both an industry advocate and safety and soundness regulator must be eliminated.

Managing the Deregulation of Banks

Limits on the powers of banks are being progressively relaxed in an unplanned fashion, yielding a risky hodge-podge of banking and other functions that could imperil the safety and soundness of the banking system. The administration must decide

- to what extent and how rapidly banks and other businesses should be allowed to merge and
- what regulatory protections are needed in the public interest.

Traditionally, and especially since the 1930s, banks have been considered special because of the unique and vital functions they perform. The segregation of banking from other lines of business, the strict supervision of banks, and insurance of their deposits have all been intended to protect these essential functions.

Despite the restraints on bank powers in the Glass-Steagall and Bank Holding Company laws, various segments of the financial services industry now compete with each other directly, offering similar products and services. Some firms have successfully challenged restrictive interpretations of existing law and now offer a wide range of services; others have been unable to do so and may be competitively disadvantaged as a result.

This ad hoc, uneven expansion of powers, which has taken place outside of the existing statutory framework, is unfair and potentially destabilizing. It is imperative that a new set of ground rules for the industry be enacted as quickly as possible. The new legislation should include the following elements:

- Relaxation of regulatory restraints should proceed in stages, keyed to the pace at which regulatory agencies are staffed and otherwise equipped to assure adequate oversight and supervision. The linchpin of the system for preserving the integrity of the financial services industry is diligent oversight by appropriate self- and government regulatory organizations. The oversight of the financial services industry has not been adequate during the past several years. It must improve.
- The holding company structure should be required for any institution that proposes to engage in both banking and nonbanking lines of business.
- Rigorous standards for adequacy of capital should be imposed at both the bank

holding company and bank levels and be firmly enforced.

- Banks should be permitted to extend credit to securities affiliates but only under carefully controlled circumstances, such as to provide liquidity in a market emergency.
- The regulatory role of the Federal Reserve should be expanded to assure effective oversight of integrated financial services firms.

Regulating Linked U.S. Financial Markets

The October 1987 crash demonstrated the volatility of financial markets, the extent to which separate markets are now intertwined, and the resulting dangers for the national economy. The administration must decide:

- how to regulate the linked markets, and
- how to prepare for a future crisis.

Since the crash, a number of changes have been suggested to enable the markets, their participants, and their regulators to better cope with sudden large swings in the price of securities. Some proposals, such as calls for changes in regulatory structure, margin requirements, and "circuit breakers," have proven highly controversial and are still being debated. Others, however, seem less open to argument and should be implemented without further delay. These include

- improving contingency planning between markets and between the different regulators;
- improving coordination of the rules and regulations that would be critical in an emergency, such as those governing the suspension of trading and those related to settlement and clearing functions; and

- retaining the Financial Market Working Group as a mechanism for assuring continued attention to the problems that emerged in the crash.

Other problems that were observed on October 19 and 20, 1987, raise fundamental questions about the adequacy of our market systems. The New York Stock Exchange (NYSE) specialist system came under heavy criticism for being unable to handle new trading volumes and interests. The over-the-counter and options markets had their share of difficulties as well. Computerized trading systems at NYSE simply could not handle the volumes experienced in October 1987. Because of NYSE's central role, its problems affected all other components in our linked futures and securities markets and fueled panicked decisionmaking. Information on the financial positions of market participants was unavailable in many cases.

There was also much confusion among banks, major clearing houses, market makers, and investors on their financial commitments to one another. These misunderstandings in the clearance and settlement process pose the greatest threat to financial stability should the circumstances of October 19 and 20 be repeated.

Finally, some investors waited for hours to find out whether their orders had been executed. Some found that they had been executed, but at prices drastically below those existing when they wanted to sell. Others did not get their orders executed at all.

In light of those problems, the administration must

- require the exchanges, at regular intervals, to seek independent assessments of the adequacy of computer operations, and require the regulatory authorities to strengthen their capacity to review automated systems that are critical to the effective operations of the exchanges;
- strengthen clearing and settlement arrangements to reduce the possibility of multiple defaults and provide a more informed basis for actions that might need to be taken during a market emergency; and
- require securities firms and markets to assure more equal access to markets by noninstitutional investors and to strengthen investor grievance procedures.

Regulating Globally Linked Markets

U.S. financial markets are linked not only with each other, but with markets in other nations. The next financial crisis—with potentially devastating effects on the U.S. economy—can begin anywhere in the world. The administration must decide the following:

- How to ensure that U.S. and foreign regulatory approaches to the securities and banking industries pursue consistent goals; and
- How to ensure that any future financial crisis is minimized through a coordinated international response.

Strong capital markets in other nations are linked with and aggressively compete against our own markets. Our own self-interest, as well as concern for the free world's economic stability, require that we exercise responsible leadership in assuring effective regulation of international securities markets. This will no doubt mean a considerably more important role for the Federal Reserve as central banker in the future.

The goals we should seek—consistency of objectives for regulation and improved crisis management—are clear, even if the precise steps needed to achieve those goals are less certain. The first stage must involve getting our own regulatory house in order by (1) resolving the future structure of the U.S. financial services industry (i.e., the banking powers issues) and (2) resolving the regulatory issues already noted with respect to the securities markets. As these are accomplished, we should simultaneously:

- Take the lead in developing mechanisms for establishing and enforcing any necessary international standards for regulation of financial markets. This effort might build on the experience of the Cooke Committee of the Bank for International Settlements, which is now recognized as the authoritative source of standards for regulating international banking.
- Take the lead in developing cooperative mechanisms that will assure the prompt exchange of critical information in time of emergency. When an emergency arises in U.S. markets, such as price volatility warranting the suspension of trading, the pressure is transmitted instantly to open markets abroad, and vice versa. There must be no delay in communicating such information between national regulatory authorities so that each can take appropriate action.

- Take the lead in developing reliable procedures for international coordination of key responsibilities. There is growing recognition that some decisions by national authorities in a banking emergency, such as central bank implementation of their lender of last resort responsibilities, can have major international ramifications. This will require more explicit lodging of responsibility for actions than was heretofore needed.

The financial services industry has played a vital role in the development of the modern U.S. economy; it must continue to play that role. At the same time, we have learned how fragile the public's confidence in our financial institutions and markets can be and how devastating a collapse can be for our economy.

The government's potential stake in resolving the industry and regulatory problems is enormous, not only in conceptual terms, but also in dollars. It could cost billions to resolve the problems pointed out in this report. With so many forms of stress now being exerted on our financial system and so many unanswered questions about how to deal with them, what is needed is a fresh, innovative approach to the regulation of our new, potentially more volatile market processes. In total, such an approach should

- protect against unacceptable financial damage to our financial institutions and markets as well as individual investors; but
- encourage innovation and be flexible enough to keep up with rapidly evolving market developments; and
- allow markets to seek their own levels of value without undue interference.

Related GAO Products

Bank Powers: Issues Related to Repeal of the Glass-Steagall Act (GAO/GGD-88-37, Jan. 22, 1988).

Financial Markets: Preliminary Observations on the October 1987 Crash (GAO/GGD-88-38, Jan. 26, 1988).

Using "Firewalls" in a Post Glass-Steagall Banking Environment (GAO/T-GGD-88-25, Apr. 13, 1988).

International Banking: Supervision of Overseas Lending Is Inadequate (GAO/NSIAD-88-87, May 5, 1988).

Thrift Industry: Trends in Thrift Industry Performance — December 1977 through June 1987 (GAO/GGD-88-87BR, May 17, 1988).

Deposit Insurance: Analysis of Reform Proposals (Summary, Vols. I & II; GAO/GGD-86-32,32A,32B; Sept. 30, 1986).

International Banking: International Coordination of Bank Supervision: The Record to Date (GAO/NSIAD-86-40, Feb. 1986).

Securities Regulation: Efforts to Detect, Investigate, and Deter Insider Trading (GAO/GGD-88-116, Aug. 5, 1988).

International Banking: U.S. Banking Supervision and International Supervisory Principles (GAO/NSIAD-86-93, June 1986).

Developments Since the Market Crash of October 1987 (GAO/T-GGD-88-33, Apr. 27, 1988).

Options for Dealing with Farm Credit System Problems (GAO/T-GGD-87-11, Apr. 7, 1987).

Banking Services: Changes in Fees and Deposit Account Interest Rates Since Deregulation (GAO/GGD-87-80, July 13, 1987).

Securities Regulation: SEC Budget and Workload Statistics, Fiscal Years 1979-1988 (GGD-87-94FS, June 22, 1987).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

United States General Accounting Office

GAO

Transition Series

November 1988

International Trade Issues

GAO/OCG-89-5TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The U.S. Trade Representative-designate

This transition report is one in a series of reports that addresses important policy, management, and program issues facing Congress and the new administration. The issues, the problems associated with each, and recommended actions are based primarily on the results of past GAO work. Some of the issues are relatively new, while others represent long-standing and unresolved problems.

This summary report identifies five important issues in the area of international trade and economic policy. They are (1) conducting economic policy in an interdependent world, (2) trade negotiations and agreements, (3) improving the management of export promotion and market development programs, (4) improving export controls, and (5) foreign direct investment in the United States. While there are undoubtedly many other issues that will demand attention, we believe those outlined in this report should be included at the top of the agendas of the Secretaries of Commerce, Agriculture, and Treasury, and the United States Trade Representative.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Conducting Economic Policy in an Interdependent World 4

Trade Negotiations and Agreements 6

Improve Management of Export Promotion and Market Development Programs 9

Needed Changes in Export Controls 13

Foreign Direct Investment in the United States 17

Related GAO Products 21

Transition Series 23

Conducting Economic Policy in an Interdependent World

The magnitude and duration of the U.S. trade deficit and the transformation of the United States from a creditor to a debtor nation have generated concern that the U.S. economy is in long-term decline. While the United States remains a rich nation and continues to generate jobs at an impressive rate, some fear that it is becoming "deindustrialized," with lost manufacturing employment being replaced with lower paying service-sector jobs, and the burden of servicing our international debt harming the U.S. standard of living.

These developments highlight the increasing interdependence of the U.S. and other nations' economies.

The new administration must formulate economic policies that balance domestic goals of steady growth, full employment, and price stability with the fact that the U.S. economy is part of an interdependent global economy. This balance of domestic goals and international realities is a permanent feature of U.S. economic policy making.

The trade deficit and the fact that the United States is a debtor nation are both principally attributable to U.S. macroeconomic policy decisions and how these policies differed from decisions made elsewhere. The United States has run persistent and large federal budget deficits and, being unable to finance them from domestic saving, has had to borrow from other nations. As a result, the United States consumed more than it produced and imported the difference—hence the trade deficit.

Substantial reductions in the trade deficit will occur only if the macroeconomic conditions that have generated the deficit are addressed. The new administration must address the imbalance between savings and the budget deficit, specifically by reducing the federal budget deficit in a manner that does not endanger long-term economic growth.

Trade Negotiations and Agreements

Negotiation and implementation of international trade agreements are central to U.S. trade policy. The aim of U.S. trade negotiations is to remove foreign barriers to imports and unfair governmental incentives to exports, thus encouraging the free flow of international trade.

The principle multilateral organization for negotiating and implementing trade agreements is the General Agreement on Tariffs and Trade (GATT). Although the GATT cannot solve all international trade problems, there are few advocates of abandoning it.

The United States, along with its major trading partners, is at the midpoint of the Uruguay Round of multilateral trade negotiations that seeks to improve and expand the GATT. The U.S. government's agenda for the Uruguay Round centers on strengthening the GATT system, making the current rules work better, expanding world market access, and extending GATT coverage to services, investment, and intellectual property rights. The negotiations are scheduled to end in 1990.

The United States has historically provided strong leadership in the GATT and, to keep the current negotiations moving forward, the new U.S. leadership must quickly develop its positions and clarify any changes it desires to make in current U.S. proposals.

The United States has been able to remove foreign barriers to U.S. exports through bilateral negotiations and agreements. The recent U.S.-Japan Market-Oriented Sector-Selective negotiations, which were undertaken to address all barriers facing several specific industries, achieved some success. This can be attributed to the direct involvement of very high-level U.S. and Japanese government negotiators as well as the characteristics of the industry sectors selected for negotiation, i.e., a history of clearly identified foreign government barriers to trade, a competitive U.S. industry with a small share of the Japanese market, industry support for negotiations, and a coincidence of interest between the two sides to the negotiations.

The new administration should keep in mind lessons from successful past negotiations when choosing future subjects for bilateral trade negotiations.

A vigorous and effective system to monitor and enforce trade agreements is essential to realize the benefits of such agreements. Even after other countries agree to trade reforms, it is often difficult to change long-standing practices; it takes time to establish new policies and procedures; there are frequently differences in interpreting the requirements of new agreements; and there are likely to be significant pockets of resistance to complying with new agreements.

Our reviews of past trade agreements found many examples in which follow up enforcement was necessary to achieve an agreement's benefits. We also found that delaying tactics and drawn out dispute settlement often frustrated U.S. efforts to gain satisfaction.

The Omnibus Trade and Competitiveness Act of 1988 strengthened the ability of the U.S. Trade Representative to enforce trade agreements and placed specific time limits on the length of efforts to settle trade disputes. Failure to gain timely satisfaction can now trigger a unilateral U.S. response.

The new administration should show strong resolve to vigorously use these new powers.

Improve Management of Export Promotion and Market Development Programs

The U.S. merchandise trade deficits reached $159 billion in 1987. Even agriculture exports, historically a significant positive factor in the overall U.S. trade balance, dropped dramatically during the first half of the decade. Government and business leaders agree that one measure to help address the trade problem is to expand U.S. exports. The United States has export promotion and market development programs designed to enhance exports. However, management problems and, in the case of Commerce, resource limitations have significantly limited their effectiveness.

Commerce Department Programs

The Commerce Department's International Trade Administration (ITA) provides a variety of services—on a cost-recovery basis—to assist U.S. businesses, particularly small- and medium-sized firms, in exporting U.S. goods and services. Most of the activities are carried out by ITA's U.S. and Foreign Commercial Service through a network of 67 domestic offices and 126 overseas posts in 66 countries. They include one-on-one business counseling, notifying U.S. firms about trade opportunities, representing U.S. firms' interests in trade and investment disputes overseas, and staging exhibitions and trade missions.

Unfortunately, the effectiveness of Commerce's export promotion activities is weakened by significant organizational and management problems which have resulted in

- a lack of accountability for program results,
- internal disagreements over roles and responsibilities,
- coordination problems for activities requiring joint efforts, and
- programming trade promotion activities with little export potential.

The Secretary of Commerce needs to streamline ITA's organizational structure and establish clear lines of authority and responsibility.

ITA's efforts to assist small- and medium-sized U.S. firms have also been weakened by conflicting goals within the agency.

In line with reduced budgets and its objective of reducing the federal role in export promotion, ITA has turned over some overseas trade promotion events to private sector organizations and no longer subsidizes the cost of participation in ITA-sponsored events.

Since the private sector has shown interest in taking over only the most profitable events, ITA is left in the difficult position of trying to recruit participants for overseas events in developing markets on a full-cost reimbursable basis. Not many small- and medium-sized firms can afford these costs.

The Secretary of Commerce must reconcile the conflict between the U.S. export promotion policy objective of helping small- and medium-sized U.S. firms and policy objectives aimed at privatization and full cost recovery for each event.

We have discussed the organizational and management problems in ITA in somewhat more detail in the transition series report entitled Commerce Issues (GAO/GGD-89-11TR). A forthcoming report provides a comprehensive analysis of ITA's export promotion programs.

Agriculture Department Programs

The Department of Agriculture's Foreign Agricultural Service (FAS) administers all market development and export promotion programs for agriculture products. FAS has staff in Washington and 75 locations overseas and is responsible for implementing about $7.2 billion in agricultural export programs each year.

FAS programs typically seek to increase agriculture exports by (1) helping to fund private sector market development efforts and (2) directly supporting export sales with loans, credit guarantees, and subsidies to reduce export prices.

FAS administers agricultural export programs with a "hands-off" approach, believing that the private sector should manage export programs with little or no government supervision or controls. FAS' lack of management control opens its programs to widespread abuse. For example, a recent investigation of tobacco exports receiving FAS export credit guarantees found that large quantities of foreign tobacco were exported under the program as U.S. tobacco.

The Secretary of Agriculture needs to improve FAS market development and export promotion program management and to put in place controls to assure accountability for public funds.

Needed Changes in Export Controls

Commerce's efforts to oversee and administer the export control system for civilian products with military applications need to be more efficient and effective.

The export control list (which determines which items require government approval for export) should be streamlined to allow export control authorities to concentrate on the most sensitive technologies. It is difficult to effectively control the full range of products and technologies subject to export control because of the huge volume of goods moving in world trade. By limiting the size of the control list, the entire system should be more effective.

The Omnibus Trade and Competitiveness Act of 1988 provides for the elimination of export licensing requirements for items at the lowest level of technological sophistication that are exported to most free world destinations but does not remove them from the control list. The Act also eliminates other licensing requirements for selected countries that control exports to the satisfaction of the United States. Under this change, the Secretary of Commerce must determine which countries are eligible for this treatment by determining that they have effective export control systems. The extent to which these provisions of the trade law reduce the burden of export controls and permit Commerce to concentrate on enforcing the most important items depends, in part, on how the Secretary of Commerce implements the act. It is important that the Secretary act expeditiously.

While Commerce administers the export control system of militarily significant commercial items and issues export licenses, the Export Administration Act of 1979, as amended, also authorizes the Defense Department to review certain license applications. Defense reviews licenses for exports to proscribed destinations and to certain free world destinations. For the latter, it currently makes license reviews assessing the potential for diversion to a proscribed destination that are similar to Commerce's evaluations.

Defense's role in making licensing decisions has been a highly contentious subject of debate in recent years. The debate centers around Defense's (1) role in reviewing licenses for the export of items to free world destinations, (2) interpretation of export control policy, and (3) evaluation of evidence used in making decisions. The issue will be vigorously debated during the next reauthorization of the Export Administration Act of 1979, as amended, and the new administration needs to establish a position on the issue.

We have found little difference between Defense recommendations on disposition of export license applications and Commerce licensing decisions with respect to exports to free world destinations. Commerce should work with Defense to eliminate unnecessary duplication at Defense.

Most export controls used to further foreign policy objectives are largely symbolic and should be used only as a last resort when diplomatic and other economic alternatives fail. The Export Administration Act of 1979, as amended, authorizes the President to establish export controls for foreign policy reasons. When these controls are symbolic, they do not prevent the targeted country from getting the controlled products from other countries. Instead, their costs are borne by American businesses in the form of export sales lost to firms in other countries. Moreover, removal of such controls without some quid pro quo is difficult even when the controls are not expected to change the objectionable behavior that precipitated them. Finally, use of such controls merely heightens perceptions that the United States is an unreliable supplier.

As a consequence, we believe that diplomatic and alternative economic measures, such as reducing the size of diplomatic missions or denying favorable tariff treatment, should be used whenever possible in lieu of foreign policy export controls.

Foreign Direct Investment in the United States

Recent widely reported acquisitions of well-known U.S. businesses and purchases of prime U.S. real estate by foreigners have raised public concern about the extent and consequences of foreign investment in the United States. The U.S. government needs to be able to assure the public that all the economic, national security, and political implications of foreign ownership of major U.S. assets have been considered.

The interagency Committee on Foreign Investment in the United States, set up in 1976, reviews selected foreign investments, and the Commerce Department's Bureau of Economic Analysis (BEA) collects data on foreign direct investment. The Census Bureau also collects business information but these data are confidential and are not shared even with other parts of Commerce. The Agriculture Department collects data on purchases of farm land by foreigners.

Despite these data sources, the detailed data needed to fully evaluate the impact of foreign direct investment are not readily available.

A major weakness in BEA's data is that they are collected on an "enterprise" basis, that is, by individual companies. The data are then aggregated by industry. However, only data on sales and employment are collected according to their actual industries. All other data of a multi-product company are included in data on the industry of its dominant economic activity. For example, the purchase of an office building by a foreign oil company would show up in data on the petroleum sector rather than as a real estate investment. Further, BEA does not collect data on an individual plant-by-plant basis. Therefore, the impact on employment in a specific location cannot be analyzed. Additionally, industry definitions for the data that are collected are very broad. For example, foreign investment in the aerospace sector cannot be adequately identified and evaluated because it falls into the broader industry category of "other transportation".

The identity of the real foreign owner is also sometimes difficult to determine. The Agriculture Department's efforts to identify the ultimate foreign investor in agricultural land go only to the third tier of corporate ownership. Its statistics show such "identity havens" as the Netherlands Antilles and Switzerland as having large shares of the foreign investment in U.S. farmland.

Census data, while very detailed, is not focused on tracking foreign direct investment.

Except for general agreement at the macroeconomic level on the policy goal of free flow of investment capital, there are differing views on what the actual economic and political effects have been for specific sectors, communities, and interests. In addition to national security concerns, debate has centered on the following issues.

Competitiveness Effects

Some investments transfer technology and management skills to the United States, but concern exists over the reverse flow of technology when high-technology U.S. firms are purchased by foreign investors.

Trade Effects

Some investments are seen as producing products that replace imports; others are viewed as magnets for imports.

Employment Effects

New foreign-owned plants may create new jobs; however, the jobs may be vulnerable to other than pure business considerations.

For example, shutdowns of foreign-owned plants may be decided on the basis of economic considerations in the home country.

Political Effects

There are concerns that political action committees of foreign-owned firms may exercise undesirable political influence.

State Incentives

Most states have sought foreign investment by offering special incentives to foreign companies, that is, subsidies. Despite the popularity of such incentives at the state level, many question whether they are in the national interest.

As these issues indicate, foreign direct investment in the United States is a complex subject. There are many ways in which the United States can and does benefit from foreign investment—yet there are some reasons for concern.

The first thing the government needs to do is improve its data collection and analysis capabilities. For example, merging available BEA and Census data may provide the information base to analyze many of the issues currently being debated.

Related GAO Products

International Trade: The U.S. Trade Deficit: Causes and Policy Options for Solutions (GAO/NSIAD-87-135, Apr. 28, 1987).

International Trade: Combating Unfair Foreign Trade Practices (GAO/NSIAD-87-100, Mar. 17, 1987).

U.S.-Japan Trade: Evaluation of the Market-Oriented Sector-Selective Talks (GAO/NSIAD-88-205, July 18, 1988).

International Finance: Competitive Concerns of Foreign Financial Firms in Japan, the United Kingdom, and the United States (GAO/NSIAD-88-171, June 24, 1988).

Personnel Management Issues in the Foreign Commercial Service (GAO/T-NSIAD-87-12. Mar. 11, 1987).

International Trade: Commodity Credit Corporation's Export Credit Guarantee Programs (GAO/NSIAD-88-194, June 10, 1988).

Agricultural Trade: Review of the Targeted Export Assistance Program (GAO/NSIAD-88-183, May 24, 1988).

Export Licensing: Commerce-Defense Review of Applications to Certain Free World Nations (GAO/NSIAD-86-169, Sept. 9, 1986).

South Africa: Summary Report on Trade, Lending, Investment, and Strategic Minerals (GAO/NSIAD-88-228, Sept. 7, 1988).

Export Controls: Commerce's Assessment of the Foreign Availability of Controlled Items Can Be More Effective (GAO/NSIAD-88-71, Feb. 9, 1988).

Foreign Investment: Growing Japanese Presence in the U.S. Auto Industry (GAO/NSIAD-88-111, Mar. 7, 1988).

International Trade: Synopsis of Recent GAO Reports on Trade Issues (GAO/NSIAD-87-103BR, Mar. 17, 1987).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

United States General Accounting Office

GAO

Transition Series

November 1988

Information Technology Issues

GAO/OCG-89-6TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Director-designate of the Office of Management and Budget

This summary report is one of a series that addresses major policy, management, and program issues facing the new administration. The issues discussed here represent the results of GAO work in the area of information management and technology.

Effective government depends directly on effective automation to support programs and initiatives. Virtually all facets of government rely on technology, but management of this technology has been uneven. Critical areas have not been given focused attention, and major computer and telecommunications systems have met with mixed success.

The possibility for significant improvement is at hand. This report describes the environment in which information technology has been managed and identifies four areas that need attention: (1) strategic planning that ties agencies' technology to their missions, (2) systems development projects that provide technical capability, (3) security that protects sensitive information, and (4) personnel who oversee complex automated systems. These areas, all of which are undergoing rapid changes, provide vital support to government operations. The new administration and the Congress have an opportunity to make lasting improvements to government services by improving management of the technology that supports these services.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

The Information Technology Environment in the Federal Government 4

Strategic Planning 9

Systems Development Projects 12

Automated Information System Security 15

Technical Personnel 18

Related GAO Products 22

Transition Series 25

The Information Technology Environment in the Federal Government

The environment in which the federal government manages its information technology is one of tensions between time, technology, cost, and talent. It is characterized by long-term projects, short-term tenures of senior and mid-level managers who often refocus program priorities, and rapid changes in technology. In addition, federal systems are often unique and extremely complex, and are acquired in an environment that is unlike private industry. Finally, the government's information technology costs are high and rapidly increasing: it is projected that about $17 billion will be spent on information technology in fiscal year 1989, as compared to $9 billion spent in 1982.

Today, information technology is essential to carrying out our nation's most vital functions. Our ability to avert war and to defend ourselves depends significantly on the strength of our computer and communications systems. Our ability to deliver social security checks to our elderly, to deliver benefits to our disabled veterans, to direct aid to needy families, all depends on the smooth operation of computer and telecommunications systems. Our nation cannot land planes safely or launch a single space vehicle without the accurate and reliable functioning of immensely complex computer technology. Our ability to raise the revenue that pays for these services is tied to automated systems that process tax information.

The role of the federal government in managing this technology is equally important: strong, informed leadership is essential to well-functioning systems. This leadership must understand the environment in which technology operates, and the particular demands that accompany federal automation projects.

Many federal projects take a long time to implement, overlapping the administrations that manage them. A multi-billion-dollar modernization program supporting social security began in 1982. Although originally estimated to be completed in 5 years, completion is still years away. From 1982 until now, it has been developed under three commissioners or acting commissioners, some of whom have changed the system's goals and objectives. A tax system redesign, which originally began in 1968, never progressed beyond the conceptual design stage and was eventually killed in 1978. It was started anew in 1982 and will cost several billion dollars between now and 1998 when completed; this renewed effort has also undergone a number of redirections by a succession of top managers.

Dramatic changes take place in information technology between the time many of the government's systems development projects start and when they end. Small computers using advanced chip technology, powerful communications technology, and large-scale, cheap mass storage are but a few recent changes. Such advances offer possibilities to revolutionize the way the government and industry do business. By the year 2000, a little more than a decade from now, the possibilities are expected to grow even more. Rapid advances coupled with long-term projects place federal managers in a difficult and challenging position as they make choices about technology.

Many federal systems are being designed as one-of-a-kind in their size and complexity. Systems supporting aviation, veterans' programs, tax administration, social security, space programs, and defense have limited private-industry models and rival or exceed the cost, size, and complexity of the largest systems of any private firm.

The government's systems are operated in an oversight arena unparalleled in private industry. The federal government's commitment to competition has been embodied and reaffirmed in legislation such as the Brooks Act, the Paperwork Reduction Act of 1980, and the Competition in Contracting Act. Its commitments to protect the privacy of citizens and the security of sensitive computerized information are set forth in the Privacy Act of 1974 and the Computer Security Act of 1987. The regulatory and budgetary environment is designed to provide a set of checks and balances to achieve the objectives of these acts and make sure that systems are effective and that their value is worth their cost.

The cost of the federal government's computer systems is staggering. For example, a system proposal for satellite control operations that is under study could cost $48 billion to implement between 1990 and 2015. Another project, the government's new telephone system known as FTS 2000, could cost up to $25 billion over the next 10 years.

The technological challenges facing this nation over the next few years call for strong leadership. The incoming administration, the Congress, and managers throughout the government must act together to ensure that our information technology works, and works well. Without this leadership, we cannot rely on our national defenses, no matter how dedicated our people or how sophisticated our equipment. Without it, we cannot hope to manage our finances, provide our social services, or guarantee the safety of our transportation systems.

Our nation's leadership must address several key issues over the next few years if we are to take full advantage of our technology. We must effectively harness this technology to accomplish our government's missions. We must make sure that our systems work as planned. We must adequately protect the information in these systems. Finally, we must get and keep the talented people needed to oversee the systems. In short, to govern our nation effectively, we must manage our technology effectively.

Strategic Planning

Strategic planning for computers and telecommunications is critical to focusing an agency's use of information resources toward achieving the mission of the organization. However, in too many instances, agencies either do not complete strategic plans or develop plans that are not effective. Moreover, strategic plans are frequently not tied to agency budget requests. As a result, millions are spent on computer systems that do not meet agency needs, do not perform as desired, are not cost-effective, and are not compatible with existing and future agency systems.

Strategic plans identify an agency's mission, relate each automation program objective to this mission, state the objectives in measurable terms, and set priorities for automation efforts. Strategic plans are also important in ensuring that systems will be integrated resources that can easily communicate with each other. Integration can be achieved by establishing and enforcing standards that ensure different systems can exchange information and share complex, expensive software.

Federal agencies frequently do not use strategic planning effectively. The nation's warning and attack assessment system's unit for monitoring communications lines has design deficiencies that will preclude its installation and use unless substantial changes are made. Besides these deficiencies, the unit is not compatible with other equipment at the operating facility.

In another case, major decisions shaping the government's planned procurement of long-distance services known as FTS 2000 have been made without adequate analysis. Because the agency did not conduct a comprehensive analysis of a range of alternatives, it was uncertain whether FTS 2000 is optimal technically, economically, or contractually.

In another instance, because plans for modernizing a worldwide military command and control system were not updated, the agency was preparing to unnecessarily spend $500 million for new computer systems. These new systems were to meet requirements that had been in most cases satisfied by previous expenditures.

Agencies do not perform effective strategic planning because top managers do not recognize its importance in directing major automation efforts. Many continue to view it as a bureaucratic exercise to comply with government regulations, rather than a necessary effort to support mission objectives.

The government needs to treat strategic planning seriously. Top-level commitment to strategic information resources planning is imperative. Specifically, agency top management needs to:

- Recognize the role and importance of strategic planning in guiding information resource activities.
- Develop, implement, and enforce strategic plans that effectively marshal information technology toward achieving the agency's mission.
- Review and update plans periodically to ensure their applicability and usefulness.
- Ensure that individual system projects are developed in accord with strategic plans.
- Ensure that strategic plans are consistent with budget requests and agency reprogramming actions.

Systems Development Projects

Some of the government's major systems development projects have had costs escalate by hundreds of millions of dollars and schedules slip by years. In many cases the new systems do not work as planned or meet user needs, and waste millions of dollars. These conditions jeopardize the government's ability to carry out some of its most fundamental missions. The following are some recent examples:

- A federal aviation system may not have been the most cost-beneficial approach because alternative system architectures were not evaluated. We estimated that a different system could reduce costs by more than $750 million.
- Evolving and expanding requirements for a defense automated financial system have caused estimated costs to grow from about $30 million to almost $500 million and schedules to slip by more than 5 years.
- Critical systems planning steps for a $1.5 billion defense logistics modernization project were not completed, making it questionable whether the system will be worth its cost, and whether it will correct existing deficiencies.
- A multi-million-dollar expansion of a system supporting veterans programs was

implemented without adequate analysis of costs and benefits. It remained questionable whether the most cost-effective system was selected.

These problems result from errors made in the early stages of a system's development. Agencies frequently do not adequately define their requirements, and therefore implement systems that do not meet users' needs. Agencies frequently do not consider less costly alternatives to the systems they select. Selected systems often are not justified, with the result that their costs greatly exceed benefits. Once program implementation is underway, problems often persist because of failure to follow approved plans, inadequate testing, inadequate supervision, and lack of management support.

Problems that arise during the development and implementation of a system can be costly and difficult to resolve. To prevent these problems, top management needs to establish good management practices to control projects through each of the system's phases: initiation, development, and operation. Specifically, agencies need to:

- Ensure that, for each systems development project, requirements are adequately defined, alternative solutions are fully evaluated, and the costs and benefits of alternatives are assessed.

- Obtain extensive user involvement, assign and retain competent staff, promote continuing communication among managers, standardize approval processes for plans and decisions, provide for complete and accurate documentation, and establish and use appropriate management controls to make decisions on system costs and schedules.

Automated Information System Security

Estimates of the annual cost of security breaches suffered by public and private institutions range into the billions of dollars. The rapid growth of automated information systems has increased the government's exposure to these risks. Recent instances of security breaches in automated information systems have resulted in the loss of assets, compromise of program objectives, and leaks of sensitive information.

Many current automated information systems are vulnerable to a range of problems because agencies do not incorporate appropriate security controls during development, and in day-to-day operations. In our 1985 review of 25 systems at 17 civilian agencies, we testified that each of these systems is vulnerable to abuse, destruction, error, fraud, and waste because of very limited use of security controls, such as risk management and audit trails.

A 1986 Office of Technology Assessment review of 142 agency components found similar weaknesses in information security controls and management practices. In 1988 we reported that, in 9 systems development projects we reviewed, management made significant project decisions without adequate consideration of potentially important security factors.

When agencies do not incorporate appropriate controls and do not adequately consider security in system development and operations, the results can be disastrous. A clerk used a transportation computer processing system to embezzle more than $800,000. Employees prepared fraudulent documents for a tax processing system, directing refunds to themselves and others. At least 30 employees obtained illicit access to computer and data files supporting agricultural programs, and made unauthorized and premature disclosure of highly sensitive information. Some federal agencies have also been the victims of computer viruses—deliberate tampering with software—that have destroyed the integrity of their software and data.

In addition to these malicious acts, agencies remain vulnerable to acts of negligence. In one review, we reported that flaws in a social security control system caused millions of dollars in erroneous payments. We further reported that a program had provisions for field office personnel to override many of the computer system's controls, and as a result incorrect and incomplete data were entered and processed.

As recognized in the recently enacted Computer Security Act of 1987, the ever-increasing use of automated systems has increased exposure to security breaches. In particular, the proliferation of telecommunications and personal computers has significantly increased the risk of unauthorized access to data.

The rapid pace of technology adds to these problems, making it difficult for security practices to keep up with changes. In addition, inattention to safeguards in the early stages of system design is common, with the result that systems must be retrofitted with security features. Retrofitting tends to be more costly and less effective than including safeguards during development.

High-level attention is needed to ensure an appropriate level of security for automated systems. Agency management must:

- Evaluate their current agency policies and procedures to assure that systems are developed and implemented with appropriate security controls built into the design.
- Improve mechanisms to detect security breaches, assess their significance, and report them to top-level officials.

Technical Personnel

Qualified technical personnel are needed at all levels if the government is to build and operate the automated information systems that provide essential services to the nation. At present, a governmentwide shortage of technical staff has resulted in many federal agencies not being able to meet crucial objectives. Some recent, highly publicized problems underscore these weaknesses, and the need for change.

The recent stock market crash revealed the inability of federal regulators to monitor the performance of computer systems of the various exchanges. Modernization of the social security system has been delayed by a shortage of management and support staff with the technical knowledge to implement and complete the project. A similar lack of technical expertise at the senior-management level has contributed to delays in the tax administration system.

Although this demonstrated lack of technical expertise has complex causes, there are underlying reasons for it: managers are having problems finding competent personnel, managers often lack necessary technical expertise themselves, and agencies are having problems keeping their most talented staff.

In a 1987 survey, about 40 percent of federal managers reported to us that their ability to hire needed staff had worsened over the past 5 years. Competition is particularly acute in expanding fields, such as computer science. The shortage of trained personnel is already apparent and is projected to become severe by the year 2000. Compounding these problems is the fact that the government is in the middle of a transition into services supported by high technology and needs to acquire technical expertise quickly.

The government is at a disadvantage when recruiting because government salaries fall far behind those in private industry. A Merit Systems Protection Board's recent survey found the government's entry-level salaries for computer specialists ranged from 22.7 to 31.6 percent less than those in private industry. The President's Commission on Compensation of Career Federal Executives found that private industry pays senior executives as much as 65 percent more than the government. The government is also at a disadvantage because questions are being raised about the way it defines the roles to be played by its technical personnel.

Unflattering perceptions of government employment further complicate efforts to recruit and keep a technical work force. Our 1987 survey showed that the greatest source of dissatisfaction among senior executives is the negative rhetoric directed toward public service.

Low pay and a bad image lead to high turnover of talented personnel. Private corporations court the best government employees with offers of high salaries and attractive working conditions. The Council of Federal Data Center Directors found in a recent survey that the employees who are most likely to leave an organization are those with the most valuable skills. Studies show that highly competent employees choose workplaces that offer good career paths, state-of-the-art systems, training, and the chance to use their abilities to the fullest.

If federal agencies are to be effectively served in the future by information technology, the government must build a first-class work force. Responsibility for ensuring that this work force is in place falls directly on the government's top-level management, who must:

- Develop, as a high priority, a strategy to hire and train senior-level, technically oriented managers, and develop career paths that will provide technically trained executives who can successfully introduce state-of-the-art technology throughout an organization.

- Develop strategies for recruiting and keeping technically skilled, junior-level staff.
- Establish special salary scales for technical personnel.

Top managers should also consider innovative approaches to focus expert technical talent on the critical issues discussed in this report. These approaches could include using advisory panels of senior industry executives experienced at introducing complex technology int' organizations.

Related GAO Products

Managing IRS: Actions Needed to Assure Quality Service in the Future (GAO/GGD-89-1, Oct. 14, 1988).

Environmental Protection Agency: Protecting Human Health and the Environment Through Improved Management (GAO/RCED-88-101, Aug. 16, 1988).

Social Security Administration: Stable Leadership and Better Management Needed to Improve Effectiveness (GAO/HRD-87-39, Mar. 18, 1987).

Department of Transportation: Enhancing Policy and Program Effectiveness Through Improved Management (GAO/RCED-87-3, Apr. 13, 1987).

Justice Department: Improved Management Processes Would Enhance Justice's Operations (GAO/GGD-86-12, Mar. 14, 1986).

Strong Leadership Needed to Improve Management at the Department of Labor (GAO/HRD-86-12, Oct. 21, 1985).

Computer Procurement: Decision Needed on Navy's Standard Automated Financial System (GAO/IMTEC-88-47, Sept. 13, 1988).

Military Space Operations: Shuttle and Satellite Computer Systems Do Not Meet Performance Objectives (GAO/IMTEC-88-7, Aug. 5, 1988).

Information Systems: Agencies Overlook Security Controls During Development (GAO/IMTEC-88-11, May 31, 1988).

Financial Markets: Status of Computer Improvements at the New York Stock Exchange (GAO/IMTEC-86-35, Apr. 27, 1988).

Federal Aviation Administration's Advanced Automation System Investment (GAO/T-IMTEC-88-3, Apr. 12, 1988).

Strong Leadership Needed to Revitalize Public Service (GAO/T-GGD-88-21, Mar. 24, 1988).

Command and Control: Upgrades Allow Deferral of $500 Million Computer Acquisition (GAO/IMTEC-88-10, Feb. 23, 1988).

ADP Modernization: IRS' Redesign of Its Tax Administration System (GAO/IMTEC-88-5FS, Nov. 9, 1987).

Information Management: Status of GSA's FTS 2000 Procurement (GAO/IMTEC-87-42, Aug. 24, 1987).

Hospital ADP Systems: VA Needs to Better Manage Its Decentralized System Before Expansion (GAO/IMTEC-87-28, July 24, 1987).

Air Force Computers: Development Risks of Logistics Modernization Program Can Be Reduced (GAO/IMTEC-87-19, May 15, 1987).

Information Management: Leadership Needed in Managing Federal Telecommunications (GAO/IMTEC-87-9, May 6, 1987).

ADP Systems: SSA's Modernization Efforts Need Redirection (GAO/IMTEC-87-16, Apr. 10, 1987).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR).

The Public Service (GAO/OCG-89-2TR).

Revenue Options (GAO/OCG-89-3TR).

Financial Services Industry Issues (GAO/OCG-89-4TR).

International Trade Issues (GAO/OCG-89-5TR).

Information Technology Issues (GAO/OCG-89-6TR).

Financial Management Issues (GAO/OCG-89-7TR).

Program Evaluation Issues (GAO/OCG-89-8TR).

Defense Issues (GAO/OCG-89-9TR).

Health and Human Services Issues (GAO/OCG-89-10TR).

Commerce Issues (GAO/OCG-89-11TR).

Agriculture Issues (GAO/OCG-89-12TR).

Justice Issues (GAO/OCG-89-13TR).

Veterans Affairs Issues (GAO/OCG-89-14TR).

NASA Issues (GAO/OCG-89-15TR).

Energy Issues (GAO/OCG-89-16TR).

Treasury Issues (GAO/OCG-89-17TR).

Education Issues (GAO/OCG-89-18TR).

Department of State Issues (GAO/OCG-89-19TR).

Environmental Protection Agency Issues (GAO/OCG-89-20TR).

Department of Labor Issues (GAO/OCG-89-21TR).

Housing and Urban Development Issues (GAO/OCG-89-22TR).

Foreign Economic Assistance Issues (GAO/OCG-89-23TR).

Interior Issues (GAO/OCG-89-24TR).

Transportation Issues (GAO/OCG-89-25TR).

Internal Revenue Service Issues (GAO/OCG-89-26TR).

United States General Accounting Office

GAO

Transition Series

November 1988

Financial Management Issues

GAO/OCG-89-7TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Secretary-designate of the Treasury
The Director-designate, Office of Management and Budget

Over the past several years, GAO has done a considerable amount of work related to improving the government's financial management. This report, which is one of a series that addresses major policy, management, or program issues facing the new administration and the Congress, summarizes our position on key elements of financial management reform which have emerged from this work. These issues are discussed in detail in the reports listed at the end of this report.

While there are many facets to be considered in rebuilding the government's financial management structure, these are the four components which we believe deserve the highest priority of the new administration and the Congress.

- Restructure the budget to include capital and operating subtotals for general, trust, and enterprise activities, and reformulate deficit reduction targets to correspond with the rev[illegible] budget structure.
- Develop politically binding agreements on multiyear macro budget targets between the White House and the Congress in a fashion similar to those set during the legislative-executive budget summit of 1987.
- Establish a chief financial officer structure for the government, which would provide leadership and direction for financial systems, reporting, and internal control improvements.
- Retain the President's Council on Integrity and Efficiency and continue its activities to coordinate

inspector general efforts to prevent and detect fraud, waste, and abuse.

Financial management reform of this nature is urgently needed to better manage the government's financial affairs, potentially save billions of dollars, and help restore the accountability of managers and the credibility of government in the eyes of the public.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Reaching for Financial Management Reform 6

The Federal Budget: A Process in Need of Change 10

Sound Financial Systems and Reporting: A Major Need 18

Effective Internal Controls: An Ongoing Commitment 26

Inspectors General: A Strong Corps Made Stronger 29

Related GAO Products 33

Transition Series 34

Tables

Table 1: Restructured Federal Budget for Fiscal Year 1987 12
Table 2: Activities Reported by Major Agencies as Having Material Internal Control Weaknesses 27

Reaching for Financial Management Reform

Major financial management reform is needed to restore integrity to government programs and credibility to their operation—thereby contributing to renewed accountability in the federal government. A broad restructuring and rebuilding of our overall financial management structure is essential and deserves a top priority of the new administration and the Congress.

Dealing with the overwhelming federal deficit is one of the most pressing issues our government faces. Reducing that deficit requires monumentally difficult decisions to be made in selecting programs and activities for reduced funding and in generating enough revenue to pay for services the public wants and needs.

If our government is to make these decisions in an informed manner, it must have better financial data. Good financial information will not make the deficit go away, nor will it make budget decisions easy. But that information can help our government better understand the issues it faces and the implications of the decisions it makes, as well as better manage scarce resources once those decisions are made.

Aside from affecting wise budget reduction decisions, poor financial systems and weak internal controls have resulted in wasteful spending, sloppy management, and losses involving billions of dollars. Agency and program managers must have reliable financial information and controls to effectively and efficiently manage their operations.

Contributing to this fiscally unhealthy condition is a federal government which faces very serious financial management problems. The budget's structure masks the severity of the deficit, its review and approval process is cumbersome, and its numbers are misleading. Information generated by the government's vast network of financial systems is unreliable. The routine audit of financial information and systems is lacking. Controls over program operations are not adequate to ensure that they are effectively run and that assets are safeguarded.

Improvements are possible. It will be difficult, but it can be done. The government is already on a path leading to better financial information and systems. But all parties involved need to work diligently to ensure continued progress and to make the improvements permanent.

To be most effective, reform must be governmentwide, serving the needs of both the Congress and the executive branch. As described more fully in other sections of this report, modernizing the federal financial management structure encompasses a number of interrelated actions.

1. Improved budget practices. Key features of budget reform are (1) restructuring the budget to include capital and operating subtotals for general, trust, and enterprise activities, (2) reformulating Gramm-Rudman-Hollings deficit reduction targets to correspond with the revised budget structure, and (3) streamlining the budget process by developing politically binding agreement on multiyear macro budget targets by the White House and the Congress.

2. Sound financial accounting and reporting. The cornerstone of improved financial systems and information requires an independent chief financial officer to provide central direction and leadership for the effort and a corresponding leadership structure in each agency.

3. Effective internal controls. A sustained commitment must be made by the administration and the Congress to the ongoing process of identifying and correcting internal control problems across the spectrum of government programs and operations.

4. Strong auditing of financial information and program operations. Greater attention and priority must be given to auditing accounting systems, financial data, and internal controls. To effectively carry out this aspect of financial reform, as well as audits and investigations of other program operations, continuity in inspector general leadership is vital.

These elements of reform would bring a fresh perspective from which to manage and control the cost of government. Budgets would be formulated and approved more efficiently. The focus of deficit reduction goals would be expanded. Agency managers and the Congress would have reliable, timely, consistent financial data as a basis for identifying problems, reaching decisions, and judging whether or not policy decisions have been properly implemented. Finally, sorely needed funds would be saved and assets protected through better internal controls and more effective auditing. These remedies to a presently ill-cast financial management structure would help in regaining the American public's confidence that its government is being effectively managed.

The Federal Budget: A Process in Need of Change

The number one fiscal problem facing the nation today is the federal budget deficit and how to reduce it.[1] Overcoming the towering hurdles of sorting out these issues is compounded by budgeting practices which impede sound management of taxpayer dollars. This section explores (1) a budget structure and process that does not provide the Congress and federal managers with the information they need to make decisions among competing demands and (2) how budget reform can be brought to the federal government.

A Restructured Budget

The current budget focuses exclusively on a single surplus or deficit number. This structure is misleading for several reasons.

First, there is no distinction between capital investments and operating expenses. This perpetuates false economies and leads to unsound deficit reduction strategies. For example, buildings and equipment are leased in cases where purchase could be more economical solely because leasing produces smaller budget numbers in the current year. Distinguishing current operations from capital investments, which is being done by a vast majority of state governments, would allow the relative needs of each to be considered when setting deficit targets.

---

[1] Budget deficit reduction policy issues are discussed in another GAO transition series report, The Budget Deficit (GAO/OCG-89-1TR).

Second, the reported deficit of $150 billion for 1987 would have been $222 billion if not offset by a $72 billion surplus in accounts classified by GAO as trust funds. The reported fiscal year 1988 deficit of $155 billion was similarly masked by billions of dollars of trust fund surpluses. The nontrust fund deficit is continuing to grow, heading toward $300 billion in the early 1990s, but it is masked by the rapidly growing Social Security reserves.

Third, the budget's bottom line does not set apart figures for enterprise operations. Unlike most programs for which funding decisions must be made, these are business-type activities, such as the Postal Service with its $30 billion-a-year program, which are generally funded through receipts from selling products or services to the public. Including the financial results expected from these operations as part of an overall budget calculation further masks the total dollars needed to fund current operations and capital investments for activities that are not intended to be self-sustaining.

Restructuring the budget produces a much clearer picture of its different components and activities. Table 1 shows GAO's recasting of the fiscal year 1987 budget,[2] which shifts the focus away from a single deficit figure of $150 billion for that year.

Table 1: Restructured Federal Budget for Fiscal Year 1987

Billions of dollars

	Activities			
Components	**General**	**Trusts**	**Enterprises**	**Total**
Operating revenues	$573	$326	$59	**$958**
Operating expenses (net)	736	258	60	**1,054**
Operating surplus or deficit	**$−163**	**$68**	**$−1**	**$−96**
Net capital financing requirements	−58	4	0	**−54**
Unified total financing requirements	**$−221**	**$72**	**$−I**	**$−150**

With the budget structured in this way, deficit reduction targets could then reflect the appropriate balance between short-term consumption needs (operating expenses) and long-term infrastructure and productivity enhancing needs (capital investments). Separate consideration could then also be given to establishing targets for capital financing, the operating deficit, and total financing requirements.

Streamlining the Budget Process

The budget process has been an annual race that was seldom won. Regular appropriations bills for fiscal year 1989 passed the Congress with only minutes to spare before the fiscal year began. This is the sole exception to a 12-year streak of late appropriations. The Congress reached its goal of delivering that budget on time by scrambling to bridge the many pitfalls accentuating today's budget process.

---

[2] Comparable information was not readily available to recast fiscal year 1988's deficit of $155 billion in a similar manner.

The budget process has been punctuated by activities which crowd out other legislative business. The percentage of budget-related rollcalls in the Senate increased from an average of 43 percent in the 1955 to 1975 period to an average of 60 percent over the 1980 to 1985 period. Even with all of this time devoted to budgeting, deadlines were still missed, funding gaps sometimes occurred between fiscal years, and omnibus continuing resolutions were passed (with little debate) in place of regular appropriations bills.

This situation is caused partly by the layering of congressional functions. Programs are revisited several times during a session by authorization, appropriation, and budget committees. Absent the discipline of a binding budget resolution and related enforcement procedures, a constantly changing budget and process is produced that, at times, seems out of control.

To eliminate unnecessary repetition, detail, and obstacles to action, the budget process should be simplified by promoting better integration among congressional leadership and the committees involved in budget matters. Another streamlining technique would be to use a biennial budgeting approach on macro budget levels, with legislative and executive branch agreement on the levels early in the budget process.

The November 1987 legislative-executive budget summit demonstrated the success possible from macro-level biennial budgeting. This summit produced an agreement, forged in the heat of the concerns raised by the stock market events of October 1987, which provided politically binding macro budget levels for 2 years and significantly streamlined the budget process for the second year of the agreement. This became a driving force behind the fiscal year 1989 appropriations legislation being enacted without need for continuing legislation—an accomplishment that had not occurred since October 1976.

Improving the Budget's Numbers and Cost Information

Putting the budget structure and process aside, we must do a considerably better job of pulling the budget numbers together and restoring the credibility of the budget. The Congress and the administration must reestablish mutual trust which has diminished in recent years.

There is a continuing problem with inadequate agency budget systems and misleading budget numbers. Frankly, the Congress does not believe the numbers it gets from the executive branch and thus develops its own numbers. Faulty figures creep into the budget in the following ways.

- Agency financial management systems do not produce reliable data from which the budget can be formulated.
- Economic assumptions and deficit projections tend to be overly optimistic.
- Numbers that appear in the budget are understated, distorted, and able to be manipulated by billions of dollars. For example, civilian employee retirement costs are not fully included, payroll payment dates are intentionally shifted from one year to another, and loan guarantees do not show up until loans go bad. Further, critical situations, such as the billions of dollars that will be needed for bailout of savings and loan institutions through the Federal Savings and Loan Insurance Corporation, do not appear in the budget as a problem until years after meaningful action can be taken to reduce the cost.

As discussed more fully later in this report, improvements are needed in agency financial management systems which will make the quality of the budget's numbers better. Also, economic assumptions should be based on more stable economic and financial trends and less upon optimistic policy and goals. The budget's cost information must also be improved by requiring that the costs for loan programs, federal civilian employee retirement, payroll, and other activities be fully and accurately reported in the budget each year.

Proposed Solutions

The budget's structure and process shortcomings only add to the already difficult task of making the tough decisions necessary to reduce the budget deficit. The budget needs to be made a more useful tool for allocating resources and a better vehicle for providing the Congress more effective ways to make budget decisions. We believe the following ideas should be considered.

- Reshape the budget to include capital and operating subtotals for general, trust, and enterprise activities.

- Form Gramm-Rudman-Hollings deficit reduction targets along the same lines as the restructured budget.

- Break the perennial budget process logjam by reaching politically binding agreement on multiyear macro budget targets between the White House and the Congress.
- Give the Congress solid budget figures to guide it in considering the hard choices demanded when legislating spending and revenue levels to lower the deficit.

Sound Financial Systems and Reporting: A Major Need

The federal government is the world's largest financial operation. Its annual outlays amount to almost a quarter of the country's Gross National Product. It employs 5 million people and runs hundreds of programs, many of them individually larger than our largest corporations and state governments and affecting the lives of virtually all Americans.

Yet, the financial management concepts and practices followed by the federal government are weak, outdated, and inefficient. The government's inability to effectively manage its financial operations contributes to the popular belief that government cannot be counted on to get anything right.

We think improvements are possible. In fact, the government is already on the road to making some of them. But it is clear that all the parties involved will need to work diligently to ensure that this progress continues and to make permanent the improvements that are already in place.

Two elements are critical to sound financial systems and reporting:

- centralized leadership responsible for developing and implementing a governmentwide plan for improving financial management systems and financial reporting and

- corresponding financial management leadership in executive branch agencies.

Financial Systems Are Weak and Outdated

The government's financial systems are in poor condition. They are incompatible and costly to operate and maintain. Systems fail to produce the complete, timely, reliable financial data needed for policymaking and day-to-day operations. This situation is further compounded by weak internal controls, which are discussed later in this report.

Today's financial reports provide a flood of information but little of the reliable operational and cost data that is essential to monitoring programs, anticipating overruns, and providing a basis for program and budget planning. Desperately needed, for example, is basic information to control and collect the billions of dollars of accounts and loans receivable owed to the government. Acting on uncollected debts is hard when simple questions about them are unanswerable, questions such as: How many receivables are really current, and how many are delinquent but being worked on or are in a restructuring phase? Administrators need reliable data, data that is consistent from one agency to the next and that is produced in a disciplined way. Too often, they must do without it.

The lack of financial data is just as crippling at the overall program management level. For example, the Veterans Administration, which runs 172 hospitals around the country, lacks information on the cost of each one or the cost of a given medical procedure at one hospital versus another. If someone were to inquire about the potential financial impact of closing a veterans hospital—or for that matter, a State Department embassy or consulate or one of the Forest Service's hundreds of offices—enough information could be brought together to form a rough estimate of the savings. That might be sufficient for onetime decision-making. But it is certainly insufficient for the program manager who must try to run a whole network of operations every day—who needs to know where things are working well, where costs are going up, where costs are going down, and where procedures are cost-effective and where they are not.

There is a lack of reliable information on weapons systems and other major projects for which multimillion or even multibillion dollar funding decisions must be made; the B-1 bomber is a classic case. Current project-reporting systems are not tied to accounting, budgeting, or project-management systems. All too often, reports are incomplete, inconsistent, or unreliable.

Many of the government's financial systems are old, with their basic structure being laid out during World War II. Hundreds of millions of dollars are spent each year on uncoordinated efforts to upgrade these systems. Despite improvement efforts over many years, the systems are second rate. As the President's fiscal year 1989 report on Management of the United States Government states, "Once a leader in the early days of automation, the Government's financial systems and operations have eroded to the point that they do not meet generally accepted standards."

Where Is Financial Management Reform Headed?

Conventional efforts to put the government's financial house in order have lacked the long-term, governmentwide approach that is necessary to ensure that consistent data are available across agency and department lines. In 1985, we issued a report entitled, Managing the Cost of Government (GAO/AFMD-85-35 and 35A), which was the culmination of a major study of the government's financial management practices. The report identified significant problems affecting the federal financial management structure, proposed a conceptual framework to guide improvement efforts, and provided an implementation strategy. Since then we have seen a growing consensus as to the need to reform the government's financial management systems and as to what needs to be done across government to accomplish meaningful and lasting improvement.

Providing Central Leadership and Continuing Direction

One positive development would be the establishment of an Under Secretary of the Treasury for Federal Financial Management who would be the government's chief financial officer. This person would provide central focus to the long-range planning of improvements and oversight of agency financial management activities. Executive branch departments and agencies would be required to establish corresponding financial management leadership positions to provide the continuity needed for improved agency financial management and support for the chief financial officer.

In July 1987, the Director of the Office of Management and Budget (OMB) administratively appointed a chief financial officer for the federal government who was given responsibility to provide leadership, policy direction, and oversight for federal financial management. Subsequently, in November 1987, OMB recommended that chief financial officers be established in the major departments and agencies. Initially, the Reagan administration did not support the need for legislatively establishing the chief financial officer position, but that view changed. The President's 1989 management report called for "legislation that will define and provide statutory underpinning for a permanent Chief Financial Officer structure throughout Government."

Equally important, the chief financial officer should develop a long-range, governmentwide financial management improvement plan. Trying to institute improvements without such a plan is like trying to build a house without a set of architect's drawings. An overall plan would generate greater confidence that the financial management system improvements would result in integrated systems for the government as well as provide information and financial reporting needed by individual agencies. Finally, an overall plan would provide direction and continuity when leadership changes occur, centrally as well as at the agency level.

Supporting Financial Management Reform Through Legislation

Financial management reform legislation is needed because experience has shown that management reforms are more likely to succeed if they have a legislative mandate. GAO studied centrally directed, governmentwide management improvements conducted in the 1970s and found that few initiatives had lasting impact. In our view, many of these initiatives would not have been so short-lived if there had been a legislative mandate to ensure that they would continue across successive administrations.

It is not surprising that administrative actions to improve operations are not fully successful, particularly when agency personnel perceive that there will be new directions from succeeding managers. A legislative mandate would provide the needed assurance that the direction and existence of financial management reform would be stable by giving it a sense of structure, force of law, permanence, and prominence.

For problems as complex and long-standing as those of federal financial management, there are no magical solutions. The situation can be righted only through painstaking, long-term efforts. These efforts cannot be haphazard; they must be made part of the government's standard operating procedure. To build in that approach so that it endures from one administration to the next will require legislation. Legislation may not solve every facet of the problem, but it will, without doubt, enable the federal government to better manage its financial affairs, save billions of dollars, and help restore the accountability of managers and the credibility of government in the eyes of the public. OMB recognized the need for financial management reform legislation in its 1989 report, Management of the Federal Government, which called for legislation that will provide a structure for implementing and sustaining financial management initiatives.

Effective Internal Controls: An Ongoing Commitment

The government does not have the internal controls necessary to effectively operate its programs and to safeguard its assets. Americans are deeply skeptical of their government's integrity. They expect an effective and efficient government, which is, at all times, fully accountable for how public moneys are spent. Seemingly never ending reports of fraud, waste, abuse, and mismanagement, however, only serve to reinforce a perception that the federal government is poorly managed, with little or no control.

Weaknesses in internal controls impede agencies' ability to carry out their responsibilities, and, in some cases, crucial programs have been hampered. This results in losses totaling millions of dollars, wasteful spending, and poor management.

Material weaknesses in controlling government operations are not limited to certain programs or areas and are not isolated instances affecting a few agencies, but span major activities across government. The following table shows the breadth of internal control problems reported by 18 major agencies in 1987.

Table 2: Activities Reported by Major Agencies as Having Material Internal Control Weaknesses

Activities	Number of agencies
Procurement	11
Grant, loan, and debt collection management	8
Eligibility and entitlement determinations	5
Cash management	6
Automated data processing	13
Property management	9
Financial management and accounting systems	14
Personnel and organizational management	12

These weaknesses in internal controls are at the very core of the government's management processes. They are serious and long-standing. To identify and correct problems such as these, the Congress enacted the Federal Managers' Financial Integrity Act of 1982. The requirements of this law are concise and straightforward: Agency managers are to evaluate and report annually to the President and the Congress on the adequacy of their internal controls and accounting systems and what is being done to correct the problems. Since the act's passage, we have seen some good results in correcting weak internal controls. However, because of constant changes in systems, people, and procedures, evaluating internal controls is an ongoing process, with identification and correction of internal control problems being a continuous objective of well-managed programs.

The administration and the Congress, therefore, need to clearly articulate priority and support for internal control improvement initiatives. In addition, the administration must take the following actions.

- Priority must be given to correcting known, long-standing internal control problems.
- At those agencies which experience internal control problems, leadership must be held accountable for improving internal controls.
- Emphasis must be given by agencies' inspectors general to the review of internal control systems and to making managers fully aware of the internal control implications of audit findings.

Inspectors General: A Strong Corps Made Stronger

While the government's budget, accounting, and internal control systems must be well-designed and operated, their effectiveness and reliability must be assessed through periodic audits and evaluations. The government's audit and evaluation process also provides critical feedback to agency managers on the effectiveness of government-financed policies, programs, organizations, projects, and activities, and on how well they are achieving their intended objectives.

Many of these functions have been carried out by presidentially-appointed inspectors general (IGs) in 19 departments and agencies, as authorized by the Inspector General Act of 1978 and similar legislation. IGs are a proven means for preventing and detecting fraud, waste, and mismanagement in federal programs and have been a key factor in strengthening federal internal audit and investigative activities and improving operations within the federal government.

The Congress, the executive branch, and the public look to IG auditors and investigators to help hold agencies accountable for the proper and efficient use of taxpayer dollars, to ensure that federal programs are meeting their intended objectives, and to foster improved internal controls and fraud prevention. In the past 10 years, IGs have produced numerous management improvements and have been credited with major savings and cost avoidance measures in federal agencies.

Maintaining Continuity of IG Leadership

High turnover among IGs at the outset of the new administration could rob the government of important expertise and insight into the most pressing problems facing agencies and how to remedy them. Government agencies and the Congress would benefit greatly from maintaining continuity of IG leadership by drawing upon the resources available through the current roster of incumbent inspectors general.

The IGs have provided independent and objective views of program operations to both agency management and the Congress. Their views can be particularly valuable in a new administration because the value of many programs and operations will likely be reassessed.

The President has the authority to appoint new inspectors general. However, consideration should be given to retaining IGs based on their individual capabilities and performance records. This would be consistent with the IG act, which provides that IGs be appointed without regard for political affiliation and solely on the basis of integrity and demonstrated ability.

Work of the President's Council on Integrity and Efficiency

Another means of maintaining continuity of leadership in the audit community is afforded through the President's Council on Integrity and Efficiency. This group, which is made up of IGs, has coordinated implementation of governmentwide activities to combat fraud and waste. The council has worked effectively to share ideas and foster innovative and effective approaches to improve government programs and operations and to identify suitable candidates for IG positions. We suggest that the activities of the President's Council on Integrity and Efficiency be continued.

Newly Authorized IGs

In October 1988, the Congress enacted legislation to establish new presidentially-appointed IGs in the Departments of the Treasury and Justice, the Nuclear Regulatory Commission, the Office of Personnel Management, and the Federal Emergency Management Agency. This legislation also provides for IGs to be appointed by the heads of 33 other agencies.

Agency heads will need to ensure that these new IG organizations become operational in accordance with the recent legislation which established them, and that they carry out their responsibilities independently and objectively. In addition, the President's Council on Integrity and Efficiency should assist the new IGs by suggesting policies and quality controls that have been effective in the 19 established IG organizations.

Related GAO Products

Managing the Cost of Government: Building an Effective Financial Management Structure (GAO/AFMD-85-35 and 35A, Feb. 1985).

Financial Integrity Act: Continuing Efforts Needed to Improve Internal Control and Accounting Systems (GAO/AFMD-88-10, Dec. 30, 1987).

Budget Reform for the Federal Government (GAO/T-AFMD-88-13, June 7, 1988).

Ten-Year Perspective on Federal Inspectors General (GAO/T-AFMD-88-16, Aug. 4, 1988).

Financial Management: Progress of OMB's Chief Financial Officer (GAO/AFMD-88-52, June 6, 1988).

Budget Issues: Trust Funds and Their Relationship to the Federal Budget (GAO/AFMD-88-55, Sept. 30, 1988).

Budget Issues: Capital Budgeting for the Federal Government (Exposure Draft—GAO/AFMD-88-44, July 1988).

Budget Issues: Current Status and Recent Trends of State Biennial and Annual Budgeting (GAO/AFMD-87-53FS, July 15, 1987).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

United States General Accounting Office

GAO

Transition Series

November 1988

Program Evaluation Issues

GAO/OCG-89-8TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Director-designate, Office of Management and Budget

This summary report is one of a series that addresses major policy, management, or program issues facing the new Congress and administration. The discussion of issues, the problems associated with each, and recommended actions are based on our work in the program evaluation area.

In this report, we are concerned with the government's continuing ability to develop, disseminate, and use sound information. Production of sound and timely information is one of the most critical functions of government. Program evaluation—along with supporting data collection—is one of the best means available for obtaining it. Yet with few exceptions, we have found that both program evaluation and data collection capabilities have been gravely eroded in the executive branch.

Officials in both executive and legislative branches need quality evaluation to help them reach sound judgments. Without this capability, executive branch policymakers are in a weak position to pursue their policy objectives with the Congress, to justify continuation of their programs, and to eliminate wasteful or unnecessary initiatives, because they lack supporting data.

The legislative branch continues to need program evaluation findings, whether or not the executive branch produces them. If the current drawdown in evaluation capabilities continues, reports from the GAO, its sister agencies, and from private sector analysts may become the only sources to which the Congress can turn for sound information to guide key decisions. The erosion of evaluation capability in the executive branch will not insulate agency programs from congressional oversight. On the contrary, lacking their own evaluations, agencies could find themselves excluded from meaningful participation in congressional decisions.

For executive agencies to preserve their proper role in policy and program implementation, four actions are needed: (1) rebuilding staff capacity, (2) providing dedicated resources for program evaluation and data collection, (3) setting priorities to ensure that information arrives when needed, and (4) ensuring honest, full reporting, both to agency policymakers and to the Congress.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Why Program Evaluation Is Important 6

The Current Decline in Evaluative Capability 9

Evaluation Findings in Specific Agencies 12

Rebuilding Capacity 19

If Agencies Don't, Others Will 23

Related GAO Products 26

Transition Series 28

Why Program Evaluation Is Important

"The Department doesn't have anything on that" is rarely an acceptable answer by federal officials to questions about their programs, yet that is a statement heard with increasing regularity.

We do not minimize the difficulties of determining program effectiveness. We do emphasize that there are proven methods for getting credible answers to questions about program operation and effectiveness. These methods collectively are called program evaluation.

When an Iranian airliner is shot down by an Aegis missile in the Persian Gulf, or when Wall Street goes into economic meltdown, the call for information comes loud and clear. Less dramatic, but equally real, are the "routine" demands for data on how effectively the federal government is using its trillion-dollar-plus budget. In 1988, for example, federal officials testified several thousand times before Congress and provided over 3,000 legislatively required reports, according to agency estimates. At the least, these reports should provide relevant, timely, and technically adequate data on federal programs.

Program evaluation—when it is available and of high quality—provides sound information about what programs are actually delivering, how they are being managed, and the extent to which they are effective or cost-effective.

Unfortunately, we have discovered through our surveys that program evaluation and the data collection that supports it are—with few exceptions—in a depleted state in executive agencies today. Further, case studies show that basic data are lacking on such disparate and wide-ranging issues as health care quality, the state of the environment, and the results of weapon system testing.

This shortage of evaluative information should be of immediate concern to federal managers: they need it both to run their programs and to justify their decisions and performance. It is certainly of concern to GAO: it means a corresponding overflow in requests to us for information on program results. But the most important point is that the shortage is really everyone's concern, because good information is not just a management tool. It is the responsibility of government to the people of this country, and it is not in a healthy state.

In the past, sound evaluations have contributed strongly to well-informed decisions, such as those to maintain effective programs like Head Start or Runaway and

Homeless Youth. Without such evaluations, these important programs might not have survived the budget cuts that depleted other programs whose effectiveness had not been so solidly established. Also, in the past, programs such as the breeder reactor or binary chemical weapons have been dropped or slowed down because evaluations convincingly showed their extreme weakness.

Today, however, the capability to perform program evaluation is drying up, not the least in such areas as defense, health care, education, and the environment, where it is precisely most needed.

The Current Decline in Evaluative Capability

Program evaluation support for the administration's top managers may be insufficient for their needs. In 1984, and again in 1988, a review of evaluation services in non-Defense agencies found a significant general decline since 1980 in the capacity and availability of data on federal programs, although agencies varied.

Professional staff in agency evaluation units decreased overall by 22 percent, from about 1,500 to about 1,200, between 1980 and 1984, while total staff for the agencies as a whole decreased only 6 percent. A 1988 study of 15 units that had been active in 1980 showed a 52-percent decrease in professional staff, an additional 12 percent since 1984.

Funds for program evaluation decreased by 37 percent between 1980 and 1984 (in constant 1980 dollars), while agency budgets had an overall increase of 4 percent. This reduction in resources slowed in the period 1984-1988, which saw a 6-percent decrease, primarily because of legislative set-asides that accounted for roughly 60 percent of total allocations in both 1984 and 1988. (In contrast, in 1980 the majority of resources came from departmental budgets.) The amount of program evaluation funds needed differs among programs, but overall, 1984 funding was only about

$111 million to cover all costs of assessing the results of all domestic programs, according to the agencies.

Despite changes in staff and funds, the number of evaluation studies decreased between 1980 and 1984 by only 3 percent. The impression of greater efficiency—same or more work with fewer resources—is misleading. The same work was not being done in 1984 or in 1988 as had been done in 1980. Work shifted from complex evaluations that give more precise measures of program effects to less complex studies and nontechnical reports.

In our 1988 sample of units, there was a greater reliance on external professionals. Unlike earlier years, when internal professionals performed small-scale, quick-turnaround studies, staff shortages appear to have reached a critical level, forcing evaluation units to contract out even small-scale studies. To make matters worse, one agency official suggested that this pool of qualified contractors is also shrinking.

Further, reports are increasingly produced at the request of program managers, and primarily for internal consumption. Evaluations for external consumption—for congressional oversight and public scrutiny—were limited in number and were primarily studies mandated by Congress, which set aside funds for this purpose.

Evaluation Findings in Specific Agencies

The concerns just mentioned about the likely quality of individual studies produced within this overall context of evaluation decline were fully borne out by our in-depth examinations of evaluation functions in four agencies. We found problems in the development, dissemination, and use of evaluations that were both consistent and extremely severe.

Inadequacies of DOD Evaluative Data

After unprecedented real growth from fiscal years 1980 to 1985, defense funding has declined and may well decline still further. The new Congress and top management will have to make difficult trade-offs among programs. Unfortunately, they may be lacking the data crucial to these decisions.

The quality of program evaluation information on some defense programs is so low that findings are misleading; in other cases, information is nonexistent; and in still others, data are incomplete. This is especially important because of the multibillion-dollar price tags on so many DOD programs. Furthermore, adequate systems are not in place for getting sound evaluative information about DOD programs to its own top managers or to Congress. For example, we found

- There were virtually no data on defense industrial production capabilities and problems at the subcontractor level. Collecting our own data, we found many unsuspected problems, including a heavy dependency on foreign suppliers, shortages of production machines and test equipment, and a large number of processes proprietary to individual contractors.

- Program testers failed to collect data on so many crucial questions in the Bigeye chemical bomb's development tests that it is unclear whether the bomb has met its specifications.

- In DOD's Live Fire Testing Program, weapons were often procured based only on computer analyses of vulnerability and lethality estimates, with little or no real data on weapon system effectiveness against actual threats under field conditions.

- The Secretary of Defense and Congress regularly receive information that contains omissions and inaccuracies in the data. They also receive assessments that consistently transmit a more favorable presentation of test adequacy and system performance than is warranted by the facts.

Tough Medicare Issues

Medicare—second only to Social Security among HHS entitlement programs—expended an estimated $70 billion, or 10 percent of the non-Defense budget, on health services to the elderly in fiscal year 1987. If current trends continue, rising federal health care costs for the elderly will overtake federal spending for retirement income. Whether efforts to control Medicare costs and reduce unnecessary care are severely damaging access to care and the quality of that care is a major issue for program evaluation today. The need is great, also, to determine whether proposed alternatives are in fact viable solutions.

The Medicare program's evaluation system today cannot support informed decisions. For example

- The Office of Research and Demonstrations—the logical unit within the Health Care Financing Administration to assume responsibility for Medicare program evaluation—has serious evaluation management problems.
- Information is meager on the quality of care that Medicare hospital patients receive.

- Information on quality of care in other settings is virtually nonexistent.

Adequacy and Availability of EPA Regulatory Data

EPA does not know whether many multibillion-dollar environmental programs are effective in achieving planned goals, because its evaluation information is misleading, inadequate, or incomplete. Shortfalls abound in the basic descriptive information needed to establish and monitor environmental regulations, and the effects of some costly environmental programs that entail considerable compliance burdens are undocumented. For example

- Data on hazardous waste volume and capacity are lacking or suspect.
- EPA has not comprehensively characterized the groundwater contaminants regulated by the states.
- The states lack important data to set technically sound groundwater protection standards.
- Major questions remain unanswered about the quality of the nation's rivers and streams.

- Data do not exist on the effectiveness of EPA's drinking water standards as protection against groundwater contamination, yet many states are using them.

- The effectiveness of the multibillion-dollar wastewater construction grants program in improving water quality has not been adequately evaluated.

- In many program areas, EPA has not conducted program evaluations to determine the health effects of risk-reduction efforts.

Our conclusions in the program evaluation area are consistent with those of the GAO general management review of EPA (RCED-88-101), which emphasized the need for the agency to set measurable objectives and to manage its resources to achieve and assess program and policy goals. On the plus side, we found that some of EPA's scientific risk assessment work has been very well conducted.

Education: C- On Information

The responsibility for collecting nationally useful information on who is getting educated, how well, and what can be done to improve the excellence of U.S. education is dispersed across evaluation, statistical, and research units throughout the Department of Education. Since the early 1970s, education studies have declined sharply.

Program evaluation studies, in particular, have declined by over 65 percent. Moreover, the statistical data produced were often stale (3-5 years, or more, out of date) and the technical quality varied.

The National Center for Educational Statistics has initiated efforts to upgrade national data bases and has overhauled its management, providing some much-needed stability and technical expertise. These improvements are new, and they will require continued management support over the next few years.

The research function could benefit from the lessons learned in reconstructing the statistical systems. Beginning in 1989, the laboratory and center systems supported by research funds are scheduled for recompetition. Currently they consume about 95 percent of the Department's non-programmatic research resources, yet no evaluative data exist on whether this is an optimal use of limited funds. How priorities for these awards are set will affect the flow of educational information for the next 5 years. For example, will top priority be set on the disadvantaged? on higher education? or on others of the many topics competing for attention?

Much of the Department's program evaluation resources are used for internal analyses of proposed policies. But in part through congressional mandates and set-asides, there are several nationally significant evaluation studies are nearing the end of the pipeline. In 1989, major evaluations of such sensitive topics as bilingual education and educational reform should be completed. In the recent past, there have been criticisms of how the Department reviews and releases this kind of policy-sensitive research. For example, headline-getting press conferences have been held before reports were available for proper professional and public review.

Rebuilding Capacity

Throughout many federal agencies the information pipeline for program oversight and management is drying up. The reduction in staff and funds needed to determine program effectiveness leaves managers unprepared to answer tough questions about program costs and results, and vulnerable to incidents such as the Vincennes situation in the Persian Gulf. Top-management support for collecting this information and insistence on honest reporting are urgently needed.

What Is Needed: Capacity

The infrastructure—the capacity for program evaluation—has generally eroded and will have to be rebuilt. For example

- Staff who are professionally trained in evaluation techniques and who also have the requisite understanding of programs will have to be recruited and trained in federal procedures. Graduate training is usually a minimum requirement for these positions.

- Many evaluation units may be inadequately staffed. As a rough estimate, one evaluator can manage about $1 million in contract activity and one manager is needed for every six or seven evaluators, depending on the size and complexity of a program.

- Locating at least one evaluation unit at the top-management level is essential, so that priorities can directly reflect agency and congressional concerns and the results can flow without censorship to the top.

- Relationships that support planning and budget functions also need to be strengthened.

What Is Needed: Resources

A notable imbalance persists in executive branch funding of program evaluation. Some agencies say they do not do any evaluations. In others, such costly programs as Clean Water lack adequate data on program effectiveness. Given the resources that can be saved through sound evaluation and the need for an agency to be able to show that its programs are effective and well managed,

- program evaluation needs to be generally strengthened throughout the government, and

- resources need to be both dedicated to program evaluation and expanded in those agencies where evaluation has been eroded or is not functioning well.

Program evaluation personnel can present a tempting target to budget cutters in times of tight resource constraints, simply because they are not line staff. This temptation must be resisted.

What Is Needed: Priorities

Within the four areas we examined in depth, we believe the top-priority evaluation issues for the next few years are:

- integrity of weapon system evaluation,
- long-term medical care needs,
- cost-effectiveness of environmental systems, and
- excellence and competitiveness of U.S. education.

Top leadership in all agencies should review their program evaluation efforts to determine what areas in their programs need highest priority attention.

What Is Needed: Honest Reporting

Some of the problems with agency evaluations have included the failure to conduct necessary studies, nontechnical influence on draft reports that have concealed or distorted findings, technical flaws affecting study quality, the uncertain access of top managers to complete and unvarnished study findings, and the limited use of evaluations in making policy.

Needed improvements in the reporting and use of program evaluation include

- assurance that objective data get to top decisionmakers. The review process that helps ensure technical adequacy and balance should not deter timeliness or candor.
- more extensive communication between requesters and evaluators in the early, middle, and late stages of a study. Such communication, which includes evaluator participation in the early formulation of data requests, is lacking, particularly in studies mandated by Congress. Communication is crucial to keeping results of costly studies off some dusty shelf and putting them onto agendas for action.
- greater attention to the prospective aspect of evaluations, before new programs, policies, or regulations are launched. "Front-end" evaluations can prevent a poor use of funds and target resources where they are most likely to be effective.

If Agencies Don't, Others Will

A consequence of the drawdown in evaluation capacity is that agencies may find themselves fenced off from evaluation-based debates about their own programs. That is, not only may agency-generated information for the public be lacking, but agencies themselves may not have the data needed to be most convincing about what they think should be started, what they think should be stopped, and what they think should be changed. The terms of the debates and the data brought to bear on these issues may be someone else's call.

Further, the problems we have described mean that to a growing extent, even GAO and others that often draw on agency records and data may be able to report little more than "Information to answer this key question is not available." That is, the loss of program evaluation information has repercussions that go beyond whether an agency head has to testify, "My Department does not have any data on that point," to whether a wide range of groups that rely in part on federally collected evaluations can independently tell Congress what is happening in the executive branch.

Over the years, the congressional appetite for the data needed for oversight on complex questions about the operations and consequences of federal programs has not slackened. Congress increasingly is relying on GAO and its sister agencies—the Congressional Budget Office (CBO), the Office of Technology Assessment (OTA), and the Congressional Research Service (CRS)—to do studies that might appropriately be conducted by executive branch agencies. We have, for example, been tasked legislatively with a major set of analyses on the effect of immigration reform and with determination of the numbers of homeless children and youth.

Clearly, if the executive branch cannot provide timely, relevant, technically adequate, and credible information on the programs that it is responsible for administering, Congress will continue to write us into legislation that mandates these important studies.

Our mission, of course, is to provide credible information to Congress and help ensure that Congress is not limited to reports from special interest, public interest, or other groups. However, although Congress may have the high ground on information, we should not, and indeed cannot, do it all. Such a role exceeds our resources. Moreover, it could lead to a serious imbalance between the branches on who calls the shots on the information that has become a vital influence in major debates on national policy and that is considered an important indicator of a credible government.

Each agency head should have, as a top priority, an honest inventory of what information is coming on line, whether it will be available in time to affect key decisions over the next 4 years, what the technical quality and relevance of the evaluations are, and what gaps need to be plugged first. In a few instances, the situation may be relatively good; but in many others, we must emphasize that a renewed commitment to program evaluation is urgently needed.

Related GAO Products

Weapons Testing: Quality of DOD Operational Testing and Reporting (PEMD-88-32BR, July 26, 1988).

HCFA Research: Agency Practices and Other Factors Threaten Quality of Mandated Studies (PEMD-88-9, June 3, 1988).

DOD Simulations: Improved Assessment Procedures Would Increase the Credibility of Results (PEMD-88-3, Dec. 29, 1987).

Education Information: Changes in Funds and Priorities Have Affected Production and Quality (PEMD-88-4, Nov. 4, 1987).

Live Fire Testing: Evaluating DOD's Programs (PEMD-87-17, Aug. 17, 1987).

Hazardous Waste: Uncertainties of Existing Data (PEMD-87-11BR, Feb. 18, 1987).

Federal Evaluation: Fewer Units, Reduced Resources, Different Studies From 1980 (PEMD-87-9, Jan. 23, 1987).

Water Quality: An Evaluation Method for the Construction Grants Program—A Methodology, Vol. 1; Case Studies, Vol. 2 (PEMD-87-4A and 4B, Dec. 17, 1986).

The Nation's Water: Key Unanswered Questions About the Quality of Rivers and Streams (PEMD-86-6, Sept. 19, 1986).

Post-Hospital Care: Efforts to Evaluate Medicare Prospective Payment Effects Are Insufficient (PEMD-86-10, June 2, 1986).

Bigeye Bomb: An Evaluation of DOD's Chemical and Development Tests (PEMD-86-12BR, May 23, 1986).

Assessing Production Capabilities and Constraints in the Defense Industrial Base (PEMD-85-3, Apr. 4, 1985).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

United States General Accounting Office

GAO Transition Series

November 1988

Defense Issues

GAO/OCG-89-9TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Secretary-designate of Defense

This transition report is one in a series of reports that address critical program management issues facing the new administration and the Congress. These issues, the problems associated with each, and recommended actions are based on the results of our work in the Department of Defense. Some of these concerns are new, whereas others represent long-standing and unresolved problems over many years.

This report identifies five important issues we believe should be included in whatever agenda the Congress and the Secretary of Defense set for our nation's defense program. These issues are (1) reducing defense costs, (2) maintaining readiness and sustainability of defense forces, (3) improving the weapon systems acquisition process, (4) improving peacetime inventory management, and (5) ensuring a first-rate management team.

These issues are discussed in detail in the reports listed at the end of this report.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Reducing Defense Costs 4

Maintaining Readiness and Sustainability of Defense Forces 8

Improving the Weapon Systems Acquisition Process 10

Improving Peacetime Inventory Management 13

Ensuring a First-Rate Management Team 15

Related GAO Products 16

Transition Series 19

Reducing Defense Costs

Between 1980 and 1985, the annual defense budget doubled. Since then, it has declined in real terms. For 1989, it stands at $300 billion and the Department of Defense (DOD) will likely have to live with constrained or no growth budgets for some time to come. Yet, each of the services says it needs many billions of dollars more to complete its modernization and expansion programs. For example, DOD recently estimated the cost of the first strategic defense system at $69 billion, while other estimates of the cost for deploying a full population protection strategic defense system range as high as a trillion dollars. In addition to the high costs to acquire weapons, additional billions of dollars will be needed to operate and maintain them. In short, DOD needs to balance strength with affordability.

DOD must adjust its proposed programs and spending patterns to recognize current fiscal realities. Its 1988-1992 five-year defense plan contained programs which would cost about $200 billion more than DOD can expect to receive during that period. And even this inflated plan would not complete all planned programs.

In November 1987, Congress and the administration reached agreement on the fiscal year 1989 budget, beginning a collaborative effort to constrain the defense budget. But much remains to be done. Steps that DOD and the Congress will need to take include the following.

- Reduce and realign planned programs. In so doing, cancel marginal systems and delay systems not ready for production. Do not continue to buy new weapons at inefficient production rates which increase costs. Also, avoid the tendency to cut operation and support funds, which results in weapons that cannot be adequately supported.
- The Secretary of Defense must provide sound fiscal guidance to the services. This will help ensure that requirements are realistically balanced with funding availability and that the five-year defense program reflects achievable goals. Fiscally achievable defense plans contribute to greater program stability. Program instability has long been recognized as a severe problem in managing weapon system programs.
- Look for common missions and families of equipment to achieve greater efficiency. In the past, for example, we have developed a variety of systems—land based to aircraft to attack tanks. While some variety

may be desirable, we must exercise greater restraint because we cannot afford to replace weapon systems on a one-for-one basis.

- Assess manpower and compensation systems, including retirement, with the goal of reducing costs. The cost of military personnel, including retirement, represents about 26 percent of the DOD budget. It is becoming too expensive to recruit, train, and retain highly skilled personnel and then have them retire at the peak of their careers. The average retirement age for enlisted personnel in 1987 was 41. The average for officers was 45.

- The Secretary of Defense needs to carefully consider the long-term cost implications of adding new weapon systems to the DOD inventory. This need is perhaps best illustrated by the decision made in the early 1980s, at a time when DOD expected continued budgetary growth, to bring four World War II battleships back into the fleet. While the activation costs for these battleships were significant (nearly $2 billion), it will cost even more to operate and maintain them. For example, this year alone, three of the reactivated battleships will cost over $150 million to operate and will require about 4,600 Naval personnel. This comes at a time when defense costs must be contained. It also comes at a time of personnel shortages.

- Rethink the viability of U.S. worldwide commitments and current levels of U.S. allies' burdensharing. The rising costs of our worldwide commitments, in the absence of increased burdensharing by our allies, may simply be unaffordable. Any reassessment of our commitments should consider force structure reductions.

Maintaining Readiness and Sustainability of Defense Forces

As DOD and the Congress look for ways to reduce the cost of defense, it is important not to shortchange the readiness and sustainability of our forces. There continues to be a sizable disparity between requirements and the resources available to meet them. For example, airlift and sealift capability are significantly below stated requirements and forces may not be able to deploy within needed timeframes. The major warfighting commands, moreover, have reservations about their ability to sustain their forces, once deployed.

There are serious shortages of sustainability items, particularly high tech, sophisticated munitions, such as air-to-air and air-to-ground missiles in the Air Force and Navy and surface-to-air munitions in the Army. Certain U.S. forces may exhaust their medical and petroleum, oil, and lubricant supplies before the first major battle is concluded. At the same time, there are billions of dollars of unneeded inventories of other items. The answer is thus not necessarily the need for more money, but the need to better manage and allocate existing funds.

A fairly recent phenomenon which deserves special scrutiny is the steady shift of missions from the active forces to the reserve forces in an attempt to reduce defense costs. There will likely be a tendency for this to continue because reserve forces cost less than active forces. The ability of the reserves to carry out their missions and support active forces is questionable. For example, about 70 percent of the Army's combat support/combat service support units are in the reserve components. However, due to personnel, equipment, and training problems, these vital support forces are not well prepared and may not be able to deploy as required. Decisionmakers should assess the readiness implications before making additional transfers of missions from the active to the reserve forces.

Improving the Weapon Systems Acquisition Process

The procurement of weapons takes a large portion of the DOD budget. With the recent revelations of fraud, waste, and abuse, the public and the Congress are seriously questioning DOD's ability to effectively manage its acquisition programs. Cost growth, extremely long acquisition times, and program stretchouts resulting in inefficient production rates remain common problems. Of the many reforms that are needed, the following stand out.

- To be efficient, the acquisition process must be stabilized. Without stability, the process will continually face uneconomical program stretchouts, cost overruns, and management inefficiencies. Since the mid-1960s, the DOD budget has been characterized by rapid growth followed by austerity followed by rapid growth again. This instability inhibits managers from making sound decisions. The incentive is to procure as much as possible while money is available. Achieving greater budget stability will go a long way toward providing the underlying foundation for sound management of defense resources and reducing the opportunities for fraud, waste, and abuse.

- Along with funding stability is the need for sound management and internal control systems. DOD is often too reactive rather than proactive in implementing its internal control programs. Industry also needs to be closely examined to ensure that it has adequate internal control systems. It may be time to consider legislation which would require annual management reports by defense contractors on their internal controls and an independent public accountant's opinion on management's representation.

- DOD needs to increase the professionalism of its procurement workforce. Frequently, key acquisition positions are filled with people who are unprepared for their assignments, especially at the program office level.
- Operational test and evaluation (OT&E) of weapon systems conducted by the military services' independent test agencies needs to be improved. The usefulness of OT&E in estimating a weapon system's performance has been limited because of insufficient resources to conduct testing, deferral of certain critical tests until after the production decision, failure to simulate realistic battlefield conditions during testing, and acceptance of products which do not meet the test criteria. There is a need for greater vigor in OT&E and greater oversight over OT&E by the Office of the Secretary of

Defense's Office of the Director of Operational Test and Evaluation.

- Over the years, congressionally required Selected Acquisition Reports (SARS), which are intended to provide data on the status of major weapon programs, have been subjected to many revisions in attempts to make them more useful and informative to decisionmakers. Unfortunately, the net effect of these changes has made the SARS rather voluminous and somewhat difficult to understand. They need to be revamped.

Improving Peacetime Inventory Management

To support its weapon systems, base operations, and other activities, DOD's supply systems contain almost 5 million different items. The sheer magnitude of these inventories makes it imperative that the military services and defense agencies maintain sound management and internal control systems which promote efficient and effective operations, support military missions, and protect inventories from fraud, waste, and abuse.

DOD's inventory of secondary items, such as spare and repair parts, is at an all-time high. At the depot level alone, the value of these items grew from $43 billion in 1980 to $94 billion in 1987. While much of this growth resulted from increased costs due to inflation and the need to support weapon systems modernization, a sizable portion represented unneeded inventories. The amount of unneeded secondary items increased from $10.1 billion in 1980 to $28.9 billion in 1988, much faster than needed items. In 1987, unneeded inventory represented 31 percent of total inventory compared with 23 percent in 1980. More efficient inventory management by the military services and defense agencies should reduce these inventories, which could free defense dollars for other areas without reducing readiness.

In the last several years, GAO and DOD have reported on serious inventory management deficiencies, such as inaccurate records, poor physical safeguards, and inadequate controls and accountability over government property furnished to contractors. While the military services and defense agencies have taken steps to address many of these problems, more needs to be done, such as

- improving systems and procedures for determining inventory requirements,
- developing better criteria for measuring and reporting on inventory management effectiveness,
- improving methods of identifying inventory inaccuracies and their causes, and
- evaluating alternative management strategies to reduce the government's inventory investment.

Ensuring a First-Rate Management Team

DOD is perhaps the largest and most complex organization in the world. Effective management of DOD has always been formidable. The unprecedented peacetime buildup of defense during this decade, coupled with disclosures of excessive prices paid for defense parts, followed by the current procurement scandal has magnified DOD's management challenges. Central to meeting these challenges is the need for a DOD management team of high quality and integrity and with sound qualifications and experience. A first-rate management team is key to effective control of the military establishment and, in turn, an efficient, effective, and economical national defense for our citizenry. Also, the Secretary of Defense must have a central role in the selection of his management team.

Related GAO Products

U.S. Defense Burden Sharing with Japan and NATO Allies (GAO/T-NSIAD-88-31, May 10, 1988).

Defense Budget and Program Issues, Fiscal Year 1989 Budget (GAO/T-NSIAD-88-18, Mar. 14, 1988).

Navy Ships: Status of the Navy's Fleet Expansion Efforts (GAO/C-NSIAD-88-3, Oct. 27, 1987).

Navy Contracting: Cost Overruns and Claims Potential on Navy Shipbuilding Contracts (GAO/NSIAD-88-15, Oct. 16, 1987).

Navy Ships: Information on Benefits and Costs of Establishing New Homeports (GAO/NSIAD-86-146, June 3, 1986).

Readiness of Army Guard and Reserve Support Forces (GAO/T-NSIAD-88-25A, Apr. 13, 1988).

Military Draft: Potential Impacts and Other Issues (GAO/NSIAD-88-102, Mar. 10, 1988).

Army Ability to Support Initial Combat Operations in Europe (GAO/T-NSIAD-88-11A, Mar. 9, 1988).

Weapons Testing: Quality of DOD Operational Testing and Reporting (GAO/PEMD-88-32BR, July 26, 1988).

Strategic Bombers: B-1B Parts Problems Continue to Impede Operations (GAO/NSIAD-88-190, July 26, 1988).

DOD Acquisition Programs: Status of Selected Systems (GAO/NSIAD-88-160, June 30, 1988).

SDI Program: Status of Phase I Strategic Defense System (GAO/C-NSIAD-88-18, June 27, 1988).

Aquila Remotely Piloted Vehicle: Its Potential Battlefield Contribution Still in Doubt (GAO/NSIAD-88-19, Oct. 26, 1987).

DOD Acquisition: Strengthening Capabilities of Key Personnel in Systems Acquisition (GAO/NSIAD-86-45, May 1988).

Defense Inventory: Growth in Secondary Items (GAO/NSIAD-88-189BR, July 19, 1988).

DOD Inventory Management: Revised Policies Needed (GAO/NSIAD-88-75, Jan. 14, 1988).

Contract Pricing: Defense Contractor Cost Estimating Systems (GAO/NSIAD-88-7, Jan. 5, 1988).

Defense Management and Procurement Issues (GAO/T-NSIAD-88-38, July 11, 1988).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

96-696 0 - 89 - 11

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

United States General Accounting Office

GAO

Transition Series

November 1988

Health and Human Services Issues

GAO/OCG-89-10TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Secretary-designate of Health and Human Services

This summary report on the Department of Health and Human Services is one in a series that addresses major policy, management, or program issues facing agency heads in the new administration. Dealing with the issues identified will be critical if the Department is to effectively serve the millions of Americans dependent on it for benefit payments and services. Some of our concerns are relatively new, while others represent long-standing and unresolved problems.

This report highlights actions that should be taken in four critical areas affecting the large and diverse operations of the Department. These include improving departmental management, containing the cost of health care, enhancing the financing and delivery of social security benefits, and implementing the recently enacted welfare reform legislation.

The issues and suggested actions pertaining to improving departmental management and the delivery of social security benefits are drawn from our general management reviews of the Social Security Administration and the Department as a whole.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Managing the Department 4

Financing the Cost of Health Care 12

Financing and Delivering Social Security Benefits 18

Strong Leadership Needed to Implement Welfare Reform 25

Related GAO Products 32

Transition Series 38

Managing the Department

The Secretary of Health and Human Services (HHS) manages the largest budget in the federal government, leads a workforce of over 120,000 people, and directs or operates more than 200 health and welfare programs. To carry out these mammoth responsibilities, the Secretary must rely on HHS's staff and management processes, structures, and systems. Breakdowns in any of these can cause failures in ongoing programs, frustrate new initiatives, and leave the Secretary vulnerable to public criticism.

Several management areas at HHS should be strengthened in order to avoid such a breakdown. HHS should invest in Department-wide planning, its personnel, and its financial and information management. HHS can eliminate role confusion among its senior executives by restructuring the role of the Department's Chief of Staff.

Initiate Departmental Planning

HHS does not have a process for steering the Department's programs and operations into the future. The lack of such a process handicaps program coordination because various Department components share no common vision or strategy for the future. Past departmental planning processes have helped the Secretary and other top leaders influence the wide range of departmental programs and activities. We believe such planning could help in the future.

Planning within HHS varies by component. The Social Security Administration (SSA) recently developed a strategic plan for its operations for the year 2000—a vision of what service delivery will look like in a decade. Similarly, the Food and Drug Administration (FDA) has developed a 2-year action plan establishing key commissioner goals and strategies to achieve them. Other components, such as the Health Care Financing Administration (HCFA) and the Family Support Administration, focus their plans primarily on current activities. Components develop these plans without a common understanding of HHS's future.

We believe the Secretary and the organization would benefit in several ways from a departmental planning process. First, a planning process would help increase the Secretary's knowledge base about the departmental activities and programs by identifying current priorities and program status—a starting point from which to direct future activities. Second, a planning process would provide staff with a better sense of the policy and management preferences of the current leaders. Third, a future vision for HHS programs can help the Department make realistic investments in the personnel, information, and financial systems that will be needed.

A workable planning system for the Department could take many different forms. The key feature must be its usefulness to the Secretary in developing and communicating a vision for the future of health and welfare programs.

The Secretary should initiate a departmental planning process that he or she can use to develop a common vision of the future direction of HHS's programs and operations.

Initiate Workforce Planning

HHS components do not have effective strategies for keeping their workforce matched to new work situations. For example, SSA has been trying to achieve a staff reduction of 17,000 by 1990 using attrition. The Department expects that increased productivity and the introduction of labor-saving technologies will help it achieve these staff reductions without degrading the quality of service. Through fiscal year 1988, SSA has lost about 12,000 positions—so far with continued high-quality service to the public. However, SSA is now trying to cut another 5,000 positions, and no one knows whether these reductions can be achieved without affecting public service. So far SSA has been lucky that the attrition has caused no serious skill imbalances that we know of. However, without workforce planning, SSA does not know how extensive further reductions can be or how rapidly they can occur without serious consequences for service quality.

Also, other HHS agencies have no systematic workforce planning processes that allow them to adjust their workforce quickly and rationally when confronted with program changes and budget cuts. For example, HCFA had no means to forestall Office of Management and Budget-initiated staff cuts that reduced the agency's size by 20 percent at the same time that radical Medicare and Medicaid policy changes were being developed and implemented. Similarly, FDA and the Centers for Disease Control were without workforce planning tools that might have helped them add or redeploy staff to cope with the new demands of the AIDS epidemic.

The Secretary should introduce a more systematic approach to workforce planning to ensure that the Department's staffs are of the size and skill mix needed to operate its programs effectively.

Invest in Management Support Systems

When we have talked with new leaders at HHS, some have expressed surprise that so many programs lack modern financial and information systems. Many of the Department's principal accounting systems are more than 15 years old. Certain financial operations, such as making accurate payments, collecting debts owed the programs, and accounting for property, have not been conducted accurately or efficiently.

Component agencies have entered the "Information Age" slowly, despite the significance and size of their operations. For example, to develop information to support the prospective payment system, HCFA had to rely on overburdened SSA computers for information processing until hand-me-down computers from the National Institutes of Health were installed. As a result, HCFA was unable to answer a number of questions asked by the Congress and the Office of Management and Budget on the effects of changing Medicare to a prospective system.

In addition, the FDA capability to approve new drugs and monitor the safety of drugs on the market has been hampered by inadequate information systems. Similarly, because SSA has had trouble developing modern software to support its operations, retirees cannot get quick service when reporting such things as the death of a spouse or a missing check.

Upgrading HHS's systems has generally proven difficult but worthwhile. A number of expensive projects to improve HHS's financial and information systems have failed to achieve their goals. However, when HHS has been successful at modernizing, substantial benefits have been obtained. For example, HHS has reported cumulative interest savings of $466 million from improved cash management activities. To successfully upgrade management systems in the Department, HHS needs top-level commitment to obtain staff with the needed skills for the job and to secure adequate funding for the activities.

The Secretary should ensure that HHS management systems are modernized by providing the necessary staff and funds to support such activities.

Restructure Role of Chief of Staff

Since 1981, secretaries of HHS have appointed chiefs of staff who have extensive involvement in the operations of the Department. The authorities of this office have not been formally established, but the incumbents have held a great deal of informal authority earned through the Secretary's trust. As currently structured, the position has no public accountability or statutory basis.

The chiefs of staff at HHS have been informally assigned authorities that have already been formally delegated to others, thereby confusing accountability within the Department. For example, the Chief of Staff has operated with authorities commensurate to those of the Under Secretary. As a result, many Department managers question the need for both an Under Secretary and a Chief of Staff, citing redundancy of responsibility, unclear lines of authority, and role confusion between the incumbents. Similar confusions have existed among the Chief of Staff and other key Department principals, such as the Assistant Secretaries for Management and Budget and for Planning and Evaluation.

The organizational conflict inherent in the Chief of Staff position could be reduced by either (1) eliminating the position, (2) confining the responsibilities of the Chief of Staff to coordination of staff offices, or (3) reorganizing the Office of the Secretary to establish two principal deputies (for example, an Under Secretary for Management and an Under Secretary for Policy) with separate but equal responsibilities.

The Secretary should restructure the role of the Chief of Staff to prevent organizational confusion among key departmental leaders.

Financing the Cost of Health Care

Most of the federal funding for health care in the United States is channelled through Medicare and Medicaid. These programs are expected to cost taxpayers $129 billion in fiscal year 1989. These programs' costs have grown rapidly in the last 20 years, and substantial cost growth is expected to continue. While attempts to contain health care costs have been, at best, only partially successful, HHS must continue to pursue the cost-containment goal. GAO's work has identified a number of positive steps that the Secretary should take, including refining Medicare's hospital prospective payment system and improving controls over payments for physician and related services. The Secretary will also have to develop a strategy for addressing the long-term care problem.

Refine Medicare's Hospital Prospective Payment System

Medicare is the largest single source of payments for hospital services, with expenditures of over $50 billion in fiscal year 1988. In 1983, the program instituted a new prospective payment system (PPS) for hospitals under which a fixed amount is paid for all cases falling within a diagnosis related group (DRG)—a set of diagnoses expected to require about the same amount of hospital resources to treat.

PPS has succeeded in its primary objective of slowing the aggregate rate of growth in

Medicare's hospital costs. However, now that it has been in place for several years, some refinements are needed to assure greater equity in PPS rates.

Under PPS, hospitals are supposed to profit or lose based on their levels of efficiency, but whether this is the case is uncertain. PPS rates were based on 1981 unaudited cost data that reflected services provided under the incentives of Medicare's former cost reimbursement system. Our work has shown that the data included large amounts of unnecessary services and/or unallowable costs. Numerous changes and adjustments have been made to PPS rates, but they have not been rebased using data reflecting current hospital operations. What relationship, if any, PPS rates bear to the costs hospitals now incur is not known.

The Secretary should rebase PPS rates using current, audited cost data so that rates reflect hospital costs under the efficiency incentives of PPS.

Our analysis has also shown excessive variation in the costs of treating patients among the various diagnoses grouped under about a third of the DRGs. Particular types of hospitals predominately treat patients at the high-cost end of the wide variation DRGs, while other types treat those mainly in the low-cost end. Thus, some types of hospitals are overcompensated and others undercompensated. The distortions also provide hospitals with incentives to seek or avoid treating patients with particular diagnoses that, in turn, could adversely affect beneficiary access to quality care.

To help assure equitable payments to hospitals, the Secretary should redefine DRGs to reduce the amount of intra-DRG variation in average treatment costs for covered diagnoses.

By statute, hospitals that have programs to train interns and residents receive higher payments under PPS than other hospitals. Our analysis has shown that the additional payments are higher than necessary to compensate these hospitals for the extra costs associated with teaching programs. Reducing the level of extra payments would substantially decrease Medicare costs.

The Secretary should seek to have the Medicare statute amended to permit reducing the level of extra payments to teaching hospitals to better reflect the additional costs associated with teaching programs.

Controlling Medicare Costs for Physician and Related Services

The costs of physician and other noninstitutional services covered under part B of Medicare has been increasing at a rate of over 15 percent per year. Past efforts to control these costs have largely failed. Savings from controls, such as payment freezes and limits on increases in charges, have been offset by higher use rates for services.

Medicare is currently moving toward the use of fee schedules for physician-related services, such as clinical laboratory tests and medical equipment used in the home, and relative value scales for physicians' services. These payment methods link rates to the time, effort, training, and other factors necessary to perform particular services or furnish items. These methods should help provide a more rational basis for service payments and more assurance of reasonable rates. By themselves, however, these payment reforms will not control overall costs because they will not control the quantity of services furnished.

The Secretary needs to come to grips with the issue of controlling service use. One step the Secretary should take is to develop benchmarks for the extent of services considered medically necessary to treat specific illnesses and to require justification for paying for services exceeding those benchmarks.

One action that has been taken to control costs is paying a fixed amount for services through capitation programs, such as health maintenance organizations. The fixed amount is supposed to be 5 percent lower on average than Medicare would spend for the same beneficiaries under the traditional fee-for-service system. However, research has shown that for beneficiaries with the same health status, Medicare costs under the capitation method are the same or higher. The problem is that the current capitation rate-setting process does not adequately make distinctions in the health needs of people who enroll in capitation plans and those who do not; thus, it is not resulting in savings.

To help assure that the savings to Medicare envisioned from using the capitation method are realized, the Secretary should refine the methods used to compute Medicare capitation rates to better reflect the health status of beneficiaries.

Financing Long-Term Care

As more and more Americans live to an advanced age and are struck by chronic health problems, the demand for and the overall costs of long-term care, both in the home and in nursing facilities, have and will continue to increase. The costs of this kind of care frequently are catastrophic, wiping out a lifetime of savings in a short period. How to assure access to long-term care without impoverishing those needing it has emerged as a dominant health issue for the elderly and their children.

Medicaid, with expenditures of about $20 billion, is the largest payer of nursing facility care. Similarly, Medicare has expenditures of over $2.5 billion making it the largest payer for home health care. The available commercial long-term care insurance has a number of shortcomings and may not be a financially viable option for many who are most in need of it. In July 1988, the Congress established the Commission on Long-Term Care to study and make recommendations on, among other things, long-term care financing mechanisms. The Commission is to issue a report in the spring of 1989, and the Secretary will have to react to any Commission recommendations.

The Secretary should develop a strategy and plan for an efficient and economical method of financing long-term care that considers the mix of private and public resources available to meet the need.

Financing and Delivering Social Security Benefits

No federal program attracts the attention of the Congress and the public like social security. It is the country's largest social program. Its receipts constitute the second largest source of federal revenue and its expenditures are second only to those of the defense budget. Since social security provides the foundation upon which most Americans build their retirement plans, any indication that promised benefits may not be paid is viewed by many as a threat to their own financial security.

From another perspective, the quality of services provided by social security employees plays a key role in shaping many citizens' view of the federal government because social security is one of the few federal programs with which almost every citizen comes into contact.

Because the social security program is so important and so visible, the Secretary should take special care to preserve the security of its financing, continue efforts to enhance public confidence in the program, and assure that SSA delivers high-quality service to the public.

Preserve the Social Security Trust Fund

Actions taken by the Congress in 1983, coupled with the recent national economic recovery, are putting the Social Security Trust Funds on a sound financial basis.

This is a far cry from the solvency crisis of 6 years ago. In 1988, total income will exceed outgo by about $44 billion, and accumulated reserves will be $112 billion by the end of the year. Reserves are expected to accumulate to $11.8 trillion by 2030 and are projected to be sufficient to pay benefits for the next 60 years.

The Congress and social security experts are beginning to debate the efficacy of building such large reserves. Some argue for delaying or reducing the scheduled payroll tax increase. Others suggest increasing benefits or using social security reserves to finance new domestic spending.

The primary concern of the Secretary should be to preserve the financial health of the social security program, both in the short run and into the next century. Whatever merit particular proposals might have, nothing should be done that would prevent the accumulation of a reserve sufficient to handle unforeseen fiscal contingencies; under current projections, it could take until 1993 or 1994 for reserves to reach these levels. Also, any changes made thereafter should at least maintain, and if possible enhance, the security of the benefit promises made to people who will be retiring in the 21st century.

A prudent course of action for the Secretary is to allow reserves to accumulate as currently scheduled until adequate contingency levels are realized. Thereafter, proposals dealing with alternative uses of trust fund reserves should be considered only if it is clear that they will not diminish assurances to future retirees.

Enhance Public Confidence in the Trust Fund

Workers have historically had little information about how much retirement income security the social security program will provide them. After well-publicized financial difficulties in the late 1970s and early 1980s, polls show that the public is still skeptical about whether the program is adequately financed and what funds will be available for them when they retire.

SSA recently started several actions to increase public awareness of social security, and improve confidence in the program. One key step has been to issue personal earnings and benefit statements to people who request them. These statements will help the public understand what they can expect from social security when they retire. Also, in March 1988, SSA was able to give the Congress audited financial statements showing the condition of the trust funds.

The Secretary should continue efforts to enhance public confidence in social security.

Improve Operations So That SSA Provides Quality Service Efficiently

SSA is responsible for paying benefits to about 39 million people and keeping earning records for most working Americans. In addition, it has contact with many millions of citizens each year. Therefore, most Americans have a stake in the efficiency of SSA's operations and the quality of services it delivers.

A key factor in managing an operation like SSA is a planning process, which guides policy, budget, and investment decisions in both the short and long term. SSA has long recognized the need for planning, but it has just recently developed a strategic planning process. Unless attention is given to completing all facets of that process and to making it work effectively, it could collapse. Key issues that need to be addressed are: identifying the specific functions that the agency will perform to support the type of service to the public envisioned by its strategic plan, determining the levels of service quality and timeliness to be achieved in the 21st century, and determining the level and type of resources needed to achieve its strategic planning goals.

SSA's operational efficiency depends in part on how well it uses new automated data processing (ADP) technology. Long described as antiquated and on the verge of collapse, its ADP system has undergone many improvements in the past decade. But the modernization cannot be completed until the key issues just cited are addressed and the ADP plan is modified to accommodate them. This will undoubtedly take time. In the meantime, SSA must keep the existing system running as efficiently and effectively as possible. Until SSA develops an ADP plan that supports the goals of the strategic plan, priority attention should be given to short-term ADP projects that maintain and improve service and, to the extent possible, facilitate systems modernization.

A related key factor in improving efficiency and, hence, service is better integration of all the technology-oriented functions namely ADP, telecommunications, software development, and data base maintenance. To accomplish this, SSA needs an information resource manager, with the responsibility and authority for setting policy and coordinating agency-wide activities relating to information resources.

The Secretary needs to assure that SSA completes all facets of its strategic planning process, adjusts its ADP plan accordingly, gives priority attention to short-term ADP projects that improve service, and appoints an agencywide information resource manager.

Develop Measures of Performance and Service Quality

To keep informed of its progress in providing quality service to the public and to allocate its resources towards the most important areas, SSA needs good performance indicators, work standards, and feedback systems. Currently, there is no systematic way for measuring public perception about the quality of all SSA services. Also, indicators used to measure performance have flaws and some important workloads are not measured at all. Historically, the agency has resisted the development of these management tools, but we think they are essential to running an efficient and effective operation particularly during times of staff cuts.

The Secretary should ensure that SSA develops and implements systems to measure the quality of the service it is providing. These should range from periodic surveys of public opinion about service to the development of operational performance indicators, which highlight how well various operational units are doing their jobs.

Strong Leadership Needed to Implement Welfare Reform

The past two decades have seen a continuing welfare policy debate centered on how to provide needy families with the basic necessities of living without discouraging them from trying to support themselves. While the policymakers debated, the system achieved neither goal adequately.

In many respects, the recent welfare reform legislation represents a new political consensus that the Aid to Families With Dependent Children (AFDC) program should place increased emphasis on promoting parental responsibility through encouraging work efforts and collecting child support payments, instead of primarily providing cash assistance. The legislation also signals a consensus that the government must help recipients move toward self-sufficiency by assuming greater responsibility for providing them with training, education, and other employment-related services and for collecting child support from absent parents.

This legislation gives the new Secretary of HHS the opportunity to create a more effective welfare system. The new approach will not succeed, however, without vigorous leadership from HHS to assure effective implementation of the program.

Reorienting Welfare

In the past, most state AFDC agencies have focused on providing cash assistance to needy families. Ensuring that absent parents also contributed to their children's support and helping custodial parents become self-sufficient received less emphasis. Welfare reform seeks to balance and integrate these three functions, promoting the idea that welfare is temporary assistance. The Secretary should ensure that the concepts driving welfare reform are endorsed both within HHS and in the states.

Implementing welfare reform, however, will be difficult for several reasons. It requires reorienting the country's view of welfare's role and, at the local level, integrating cash assistance with child support and work/training efforts. However, paying out benefits at the right time and in the right amount is much easier than helping someone acquire the self-esteem and skills needed for work or collecting support from an absent parent whose whereabouts are unknown. In assuring that welfare reform's goals are met, HHS must assume roles that are not always compatible, assisting the states in implementing the new program while simultaneously monitoring compliance.

The Secretary must provide leadership to reorient the country's thinking about welfare and facilitate integration of welfare functions at the local level, balancing the roles of promoter and monitor of welfare reform.

Strengthening Programs to Promote Parental Responsibility

To increase the emphasis on promoting parental responsibility, welfare reform prescribes in detail many actions the states must take to provide employment-related services and enforce child support, and strengthens the federal role in overseeing these two functions. Based on our previous work, we believe several aspects of the new work/welfare and child support programs warrant special attention as HHS implements this legislation.

Three areas are particularly important in assuring that recipients obtain the education and skills they need to find jobs. First, welfare reform includes requirements and incentives for states to target services on long-term welfare recipients or those at risk of becoming long-term. We have found that some state programs currently may exclude these people from their work programs, because program performance is often judged by success rates in achieving short-term goals. HHS will have to assure that these states retarget their programs, but it will also have to develop performance standards that recognize the difficulties in serving this group and are sensitive to the length of time needed to show results.

Second, the reform measure clearly intends that a comprehensive array of needed services, including education and training, be available to program participants. Our work has shown that while many current programs claim to offer these kinds of services, they do not actually provide them to many clients. HHS will have to ensure that participants who need more intensive services, such as education and training, actually receive them.

Third, welfare reform emphasizes the importance of child care, especially for women with children less than 6 years old. Some current programs offer this assistance only as a last resort and many do not monitor the quality of the care paid for by the program. HHS will have to ensure that assistance is readily available to participants and the care is of good quality.

The Secretary must ensure that states develop welfare employment programs that target people at risk of dependency, actually deliver the comprehensive employment services these people need, and provide quality child care services.

In strengthening child support enforcement, welfare reform continues the movement of the 1984 Child Support Amendments to compel a stronger HHS involvement than the agency has chosen to exert in the past. Our work suggests three components that deserve special attention by the Secretary.

First, the reform legislation sets forth specific performance standards for determining paternity and requires the Secretary to include time limits for states to respond to requests for child support assistance. We have emphasized the need for such standards not only for paternity determination but for each child support service—locating absent parents, establishing support orders, and so on. Along with concerted efforts to establish performance standards for each child support service, the Secretary should ensure that HHS establishes procedures for monitoring states' performance in the future.

Second, the new law makes wage withholding automatic, starting 25 months after the law's enactment, even if support payments are not delinquent. In view of the lengthy time periods required by some states in implementing the wage withholding requirements of the 1984 Amendments, we believe the Secretary should take steps to ensure states are prepared to implement this procedure as soon as the requirement takes effect. Also, the Secretary should explore ways to encourage states to use such other proven collection techniques as liens on real and personal property and credit bureau reporting.

Third, states must have in operation by October 1, 1995, statewide automated child support enforcement systems that meet requirements that the Secretary prescribes. Heretofore, such systems were optional, and the federal government provided incentives through enhanced funding available since 1981. In view of the relatively slow progress states have made developing such systems in the past—only two states' systems were fully operational as of May 1988—we believe the Secretary should ensure states are provided technical assistance in planning and designing these systems to meet the statutory deadline.

The Secretary should provide strong leadership to establish performance standards, encourage states to use proven support collection techniques, and aggressively promote automated child support enforcement systems.

Related GAO Products

Financing the Cost of Health Care

Medicare: Experience Shows Ways to Improve Oversight of Health Maintenance Organizations (GAO/HRD-88-73, Aug. 17, 1988).

HCFA Research: Agency Practices and Other Factors Threaten Quality of Mandated Studies (GAO/PEMD-88-9, June 3, 1988).

Medicare: Refinement of Diagnosis Related Groups Needed to Insure Payment Equity (GAO/HRD-88-41, Apr. 22, 1988).

Medicare: Uncertainties Surround Proposal to Expand Prepaid Health Plan Contracting (GAO/HRD-88-14, Nov. 2, 1987).

Long-Term Care Insurance: Coverage Varies Widely in a Developing Market (GAO/HRD-87-80, May 29, 1987).

Medicaid: Determining Cost-Effectiveness of Home and Community-Based Services (GAO/HRD-87-61, Apr. 28, 1987).

Medicaid: Lessons Learned From Arizona's Prepaid Program (GAO/HRD-87-14, Mar. 6, 1987).

Medicare: Issues Raised by Florida Health Maintenance Organization Demonstrations (GAO/HRD-86-97, July 16, 1986).

Medicare: Past Overuse of Intensive Care Services Inflates Hospital Payments (GAO/HRD-86-25, Mar. 7, 1986).

Use of Unaudited Hospital Cost Data Resulted in Overstatement of Medicare's Prospective Payment System Rates (GAO/HRD-85-74, July 18, 1985).

Medicare's Policies and Prospective Payment Rates for Cardiac Pacemaker Surgeries Need Review and Revision (GAO/HRD-85-39, Feb. 26, 1985).

Excessive Respiratory Therapy Cost and Utilization Data Used in Setting Medicare's Prospective Payment Rates (GAO/HRD-84-90, Sept. 28, 1984).

Medicare and Nursing Home Care: Cost Increases and the Need for Services Are Creating Problems for the States and the Elderly (GAO/IPE-84-1, Oct. 21, 1983).

Improving Medicare and Medicaid Systems to Control Payments for Unnecessary Physicians' Services (GAO/HRD-83-16, Feb. 8, 1983).

Social Security

Social Security Administration: Stable Leadership and Better Management Needed to Improve Effectiveness (GAO/HRD-87-39, Mar. 18, 1987)

Social Security: Decision to Implement Nationwide 800 Telephone Service (GAO/HRD-88-120, Sept. 21, 1988)

Social Security: Little Overall Change in Telephone Accessibility Between 1985 and 1988 (GAO/HRD-88-129, Sept. 15, 1988)

Social Security: Staff Reductions and Service Quality (GAO/HRD-88-97, May 13, 1988)

Social Security: The Notch Issue (GAO/HRD-88-62, Mar. 24, 1988)

Immigration Control: A New Role for the Social Security Card (GAO/HRD-88-4, Mar. 16, 1988)

Social Security: Payment Accuracy Rates Are Overstated (GAO/HRD-88-10, Oct. 29, 1987)

Social Security: More Must Be Done to Credit Earnings to Individuals' Accounts (GAO/HRD-87-52, Sept. 18, 1987)

Social Security: Staff Reductions and Service Quality (GAO/HRD-87-139BR, Sept. 17, 1987)

Social Security: Clients Still Rate Quality of Service High (GAO/HRD-87-103BR, July 14, 1987)

Social Security: Improved Telephone Accessibility Would Better Serve the Public (GAO/HRD-86-85, Aug. 29, 1986)

Social Security: Issues Relating to Agency Field Offices (GAO/HRD-86-71BR, Mar. 31, 1986)

Social Security: Actions and Plans to Reduce Agency Staff (GAO/HRD-86-76BR, Mar. 17, 1986)

Social Security: Past Projections and Future Financing Concerns (GAO/HRD-86-22, Mar. 11, 1986)

Quality of Services Generally Rated High by Clients Sampled (GAO/HRD-86-8, Jan. 30, 1986)

Social Security: Treasury's Management of Social Security Trust Funds During the Debt Ceiling Crisis (GAO/HRD-86-45, Dec. 5, 1985)

Welfare Reform

Welfare Reform: Projected Effects of Requiring AFDC for Unemployed Parents Nationwide (GAO/HRD-88-88BR, May 23, 1988)

Problems GAO Identified in Work on Child Support Enforcement Program (GAO/T-HRD-88-8, Feb. 23, 1988)

Welfare: Expert Panels' Insights on Major Reform Proposals (GAO/HRD-88-59, Feb. 3, 1988)

Work and Welfare: Analysis of AFDC Employment Programs in Four States (GAO/HRD-88-33FS, Jan. 5, 1988)

Findings on Current AFDC Work Programs and Implications for Pending Legislation (GAO/T-HRD-87-12, Apr. 30, 1987)

Child Support: Need to Improve Efforts to Identify Fathers and Obtain Support Orders (GAO/HRD-87-37, Apr. 30, 1987)

Observations on How the Office of Child Support Enforcement Could Better Help States Efficiently Automate Their Child Support Enforcement Programs (GAO/IMTEC Letter B-221220, Feb. 20, 1987)

Welfare: Issues to Consider in Assessing Proposals for Reform (GAO/HRD-87-51BR, Feb. 19, 1987)

Work and Welfare: Current AFDC Work Programs and Implications for Federal Policy (GAO/HRD-87-34, Jan. 29, 1987)

Child Support: States' Progress in Implementing the 1984 Amendments (GAO/HRD-87-11, Oct. 3, 1986)

Child Support: States' Implementation of the 1984 Child Support Enforcement Amendments (GAO/HRD-86-40BR, Dec. 24, 1985)

Evidence Is Insufficient to Support the Administration's Proposed Changes to AFDC Work Programs (GAO/HRD-85-92, Aug. 27, 1985)

U.S. Child Support: Needed Efforts Underway to Increase Collections From Absent Parents (GAO/HRD-85-5, Oct. 30, 1984)

Child Support Collection Efforts for Non-AFDC Families (GAO/HRD-85-3, Oct. 30, 1984)

CWEP's Implementation Results to Date Raise Questions About the Administration's Proposed Mandatory Workfare Program (GAO/PEMD-84-2, Apr. 2, 1984)

(118832)

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

United States General Accounting Office

GAO

Transition Series

November 1988

Commerce Issues

GAO/OCG-89-11TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Secretary-designate of Commerce

This summary report, one in a series that addresses major policy, management, or program issues facing major agency heads in the new administration, is based on our work relating to the Department of Commerce. Some of our concerns are relatively new, while others represent long-standing and unresolved problems.

This report identifies four important issues we believe should be included in whatever agenda Congress and the Secretary of Commerce set for the Department. They involve the need to (1) improve the Department's export promotion activities, (2) improve export controls, (3) address planning and decisionmaking problems associated with the decennial census, and (4) monitor progress on development of the new automated patent system.

These issues are discussed in detail in the reports and testimonies listed at the end of this report.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Improve U.S. Export Promotion Activities 4

Needed Changes in Export Controls 8

Early Planning and Timely Decisions Needed to Control Escalating Decennial Census Costs 12

Closely Monitor Development of the New Automated Patent System 17

Related GAO Products 19

Transition Series 21

Improve U.S. Export Promotion Activities

Our merchandise trade deficit reached $159 billion in 1987. One way to help reduce the trade deficit is to export more of America's competitive products.

But part of the solution lies in improving our export promotion activities. This is the role of the International Trade Administration (ITA). It provides a range of services through a network of 67 domestic offices and 126 overseas posts in 66 countries to assist U.S. businesses, particularly small- and medium-sized firms, in exporting U.S. goods and services. ITA services include one-on-one business counseling, notifying U.S. firms about trade opportunities, representing U.S. firms' interests in trade and investment disputes overseas, and staging exhibitions and trade missions.

Unfortunately, the effectiveness of Commerce's export promotion activities is weakened by significant organizational and management problems.

Major ITA reorganizations in 1980 and 1982, and several other smaller ones, exacerbated existing problems in the planning and execution of overseas trade promotion activities. The reorganizations were supposed to enhance the industrial analysis capabilities of ITA to facilitate trade policy initiatives. However, the reorganizations also divided responsibility for trade promotion among three ITA units with different orientations, increased substantially the number of assistant secretary-level positions (from 3 to 27), and compartmentalized most activities.

The cumulative effect is

- a lack of accountability for program results,
- internal disagreements over roles and responsibilities, and
- coordination problems for activities requiring joint efforts.

These organizational weaknesses have contributed to the selection of questionable trade promotion events and the scheduling of activities in countries with little or no commercial potential. As a result, more than half of annually scheduled, publicly announced overseas trade events are cancelled.

The Secretary needs to

- streamline ITA's organizational structure,

- clarify the responsibilities of ITA's operating units to eliminate or minimize overlap, and
- hold managers accountable for the success of scheduled trade promotion events and a reduction in cancellations.

ITA's efforts have also been marked by conflicting goals and reduced budgets for export promotion activities.

ITA's primary clients are supposed to be small- and medium-sized U.S. firms. However, certain other policy goals have weakened ITA's ability to serve this client population.

In the past, some ITA overseas trade events were priced to allow for reduced fees in events oriented toward small- and medium-sized, new-to-export/new-to-market firms, and to support market development. However, this flexibility has basically been eliminated.

In line with reduced budgets and its objective of reducing the federal role in export promotion, ITA has turned over some overseas trade promotion events to private sector organizations and no longer subsidizes the cost of participation in ITA-sponsored events. ITA now prices all activities on a full-cost recovery basis.

Since the private sector has shown interest in taking over only the most profitable events, ITA is left in the difficult position of trying to recruit participants for events in developing markets on a full-cost basis. Not many small- and medium-sized firms can afford these costs.

The Secretary of Commerce must reconcile the conflict between the U.S. export promotion policy objective of helping small- and medium-sized U.S. firms and the policy objectives aimed at privatization and full-cost recovery for each event.

Needed Changes in Export Controls

Commerce's efforts to oversee and administer the export control system for civilian products with military applications need to be more efficient and effective.

The export control list, which determines which items require government approval for export, should be streamlined to allow export control authorities to concentrate on the most sensitive technologies. It is difficult to effectively control the full range of products and technologies subject to export control because of the huge volume of goods moving in world trade. By limiting the size of the control list, the entire system should be more effective.

The Omnibus Trade and Competitiveness Act of 1988 provides for the elimination of export licensing requirements for the least technologically sophisticated items that are exported to most free world destinations.

The act, however, does not remove the items from the control list. The act also eliminates other licensing requirements for selected countries that control exports to the satisfaction of the United States. Under this change, the Secretary of Commerce must determine which countries are eligible for this treatment by determining that they have effective export control systems. The extent to which these provisions of the trade law reduce the burden of export controls and permit Commerce to concentrate on enforcement of the most important items depends, in part, on how the Secretary implements the act. It is important that the Secretary act expeditiously.

While Commerce administers the export control system for militarily significant commercial items and issues export licenses, the Export Administration Act of 1979, as amended, also authorizes the Defense Department to review certain license applications. Defense reviews licenses for exports to proscribed and certain free world destinations. For the latter, it currently makes license reviews assessing the potential for diversion to a proscribed destination, similar to the way Commerce does its evaluations.

Defense's role in making licensing decisions has been a highly contentious subject of debate in recent years. The debate centers around Defense's (1) role in reviewing licenses for the export of items to free world destinations, (2) interpretation of export control policy, and (3) evaluation of evidence used in making decisions. The issue will be vigorously debated during the next reauthorization of the Export Administration Act of 1979, as amended. The new administration needs to establish a position on the issue.

We have found little difference between Defense's recommendations on the disposition of export license applications and Commerce's licensing decisions on exports to free world destinations. Commerce should work with Defense to eliminate unnecessary duplication at Defense.

Most export controls used to further foreign policy objectives are largely symbolic and should be used only as a last resort when diplomatic and economic alternatives fail. The Export Administration Act of 1979, as amended, authorizes the President to establish export controls for foreign policy reasons. When these controls are symbolic, they do not prevent the targeted country from getting the controlled products from other countries. Instead, their costs are borne by American businesses in the form of export sales lost to firms in other countries.

Moreover, removal of such controls without some quid pro quo is difficult even when the controls are not expected to change the objectionable behavior that precipitated them. Finally, use of such controls merely heightens perceptions that the United States is an unreliable supplier. As a consequence, we believe that diplomatic and alternative economic measures, such as reducing the size of diplomatic missions or denying favorable tariff treatment, should be used whenever possible instead of foreign policy export controls.

Early Planning and Timely Decisions Needed to Control Escalating Decennial Census Costs

Controlling the escalating cost of, and recruiting quality people for, the 1990 Decennial Census will be two of the immediate and important challenges facing the new administration. Similarly, much of the cost of the 2000 Decennial Census will depend on the speed and quality of the planning and decisionmaking done in the early 1990s. However, if the past is any indication, Commerce will experience serious problems with both censuses unless changes in management's approach and practices are made at the Bureau of the Census.

Action Needed Now for the 1990 Decennial Census

Decennial census costs have increased dramatically.

- The Bureau spent $221 million to take the 1970 census. The cost for the 1980 census was $1.1 billion. Even when inflation and workload are taken into account, the 1980 costs doubled from the prior census.

- Official estimates for the 1990 census project a cost of $2.6 billion. However, past experience in the 1980 census and indications from recent activities suggest that the 1990 census could exceed $3 billion.

- If the cost escalation rates of the recent past continue, with no change in the general census methodologies, the total cost for the 2000 census could reach $6 billion or more.

In 1980, the Bureau ran out of money and was forced to reduce certain operations and eliminate others. The potential shortfall appears even larger for 1990.

Timely decisionmaking is essential because the Bureau's efforts to reduce costs may be exacerbated by recent problems in attracting and retaining enough people to carry out initial 1990 Decennial operations. The Bureau will need over 300,000 temporary employees, and personnel costs represent a major component of a decennial census.

To date the Bureau's wage scale does not appear attractive in some high-cost areas, hampering recruitment efforts. Potential increases in the minimum wage would increase the attractiveness and competitiveness of other employment opportunities in some areas. This would further compound the Bureau's recruitment problems and would possibly result in increased costs. Obtaining and training a sufficient temporary workforce was a problem in 1980 and, given the increasing competition for quality workers, the problem is likely to intensify by 1990.

The Secretary of Commerce needs to

1. Hold the Bureau accountable for developing and implementing a cost reduction plan aimed at controlling decennial census costs and ensuring timely decisions.

2. Ensure that the Bureau takes steps to avoid further escalation in census costs and meets its staffing goals.

Early Planning and Timely Decisionmaking for the 2000 Decennial Census Needed

Early planning and timely decisionmaking are critical if the decennial census is to be effectively managed and executed. This is especially important given the increasing reliance on automated procedures and equipment for taking the census, which require long lead times for acquisition and development.

The Bureau's planning efforts generally start late, experience delays, are incomplete, and fail to fully explore innovative approaches. This leaves many key operational issues undecided. Weaknesses in the Bureau's planning activities and its failure to make timely decisions are its most serious management problems and will likely contribute to a less efficient and more costly 1990 Decennial Census. Cost control efforts have not been emphasized at the Bureau.

Since the 1990 census will occur during the new administration's tenure, the new Secretary of Commerce will immediately focus on its management. The next 4 years will also represent a critical time frame for the 2000 Decennial Census. The policy and operational foundations and framework which will impact on future Census operations and costs should be set during this period. Therefore, this time frame represents Commerce's best opportunity to affect how Census will be run in the future.

The Bureau will need to complete its plans for the 2000 census early in the decade to have sufficient time for effective execution. This is especially important if methodological changes are to be considered to reduce cost escalation.

Accordingly, the Secretary should

1. see that Census develops and implements an effective management structure, planning capacity, and decision timetable in sufficient time to help guide Census in making the decisions and changes necessary for the 2000 census, and

2. hold Census accountable for rigorous exploration of cost control approaches and

alternative methodologies for doing the 2000 census.

Closely Monitor Development of the New Automated Patent System

Commerce's Patent and Trademark Office (PTO) has undertaken a major effort to develop an automated patent system. The project, estimated to cost about $448 million, has experienced serious problems. Commerce recently said it took actions to strengthen management of the project and improve technical design. However, continued top-level attention is needed to ensure the project will properly support PTO's important patent mission.

Commerce has not adequately overseen the planning for this project, and PTO has spent millions with little assurance it was implementing the best alternative. The automation effort has been fraught with problems caused by inadequate planning and oversight. As a result, PTO has had to change its expectations for the system, revise its cost estimates for the project, rewrite the statement of work to clearly reflect what is required of the contractor, and renegotiate the terms of the contract.

The Automated Patent System is an ambitious effort using state-of-the-art technology and will be relied upon to carry out one of PTO's primary missions. The failure of this system to operate as intended could jeopardize PTO's ability to carry out its mission and waste millions of dollars.

Closely Monitor Development of the New Automated Patent System

After we had reported serious management problems with the development of the new system, Commerce formed a panel of National Bureau of Standards and industry computer experts to review the Automated Patent System. The panel recently issued a report that noted progress in the development of automated search and retrieval of patents but criticized the system design and management effort.

The panel recommended changes that it estimates could save $70 million in acquisition costs on the project. Commerce said it is implementing the panel's recommendations and has established a new Assistant Commissioner of Information Systems position to provide additional oversight on PTO's automation projects.

It is critical that effective management controls be in place to ensure that cost, schedule, and performance problems are promptly identified and addressed.

Related GAO Products

Personnel Management Issues in the Foreign Commercial Service (GAO/T-NSIAD-87-12, Mar. 11, 1987).

Commerce's Assessment of the Foreign Availability of Controlled Items Can Be More Effective (GAO/NSIAD-88-71, Feb. 9, 1988).

Commerce/Defense Review of Applications to Certain Free World Nations (GAO/NSIAD-86-169, Sept. 16, 1986).

Assessment of Commerce Department's Foreign Policy Report to Congress (GAO/NSIAD-86-172, Aug. 19, 1986).

Status of the 1990 Decennial Census (GAO/T-GGD-88-53, Sept. 27, 1988).

Decennial Census Minicomputer Procurement Delays and Bid Protests: Effects on the 1990 Census (GAO/GGD-88-70, June 14, 1988).

The Census Bureau Needs to Plan Now for a More Automated 1990 Decennial Census (GAO/GGD-83-10, Jan. 11, 1983).

ADP Systems: Patent Office's Contract Renegotiation Behind Schedule (GAO/IMTEC-87-35, July 31, 1987).

ADP Acquisitions: Patent Automation Encountering Major Planning and Procurement Problems (GAO/IMTEC-86-19, July 17, 1986).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

United States General Accounting Office

GAO

Transition Series

November 1988

Agriculture Issues

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Secretary-designate of Agriculture

This report is one of a series that summarizes major policy, management, and program issues facing agency heads in the new administration. Through our work in these areas, we have identified many concerns—some relatively new, others long-standing.

This report on the Department of Agriculture describes our concerns about (1) improving the effectiveness and reducing the costs of farm programs, (2) reducing the cost of Farmers Home Administration loan programs, (3) finding long-term answers to reduce the dairy surplus, (4) strengthening the financial viability of the Federal Crop Insurance Program, (5) enhancing U.S. agricultural competitiveness, and (6) improving the delivery of food stamp benefits. We also offer a wide range of observations and suggestions about how the Secretary of Agriculture can best address these concerns.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Improving the Effectiveness and Reducing the Cost of Farm Programs 4

Reducing the Cost of FmHA Loan Programs 11

Finding Long-Term Answers to Reduce the Dairy Surplus 15

Strengthening the Financial Viability of the Federal Crop Insurance Program 19

Enhancing U.S. Agricultural Competitiveness 23

Improving the Delivery of Food Stamp Benefits 28

Related GAO Products 33

Transition Series 35

Improving the Effectiveness and Reducing the Cost of Farm Programs

The anticipated 1990 farm bill will be the latest in a series of agricultural laws that date from the Great Depression. The most recent farm bill—The Food Security Act of 1985—moved U.S. agriculture towards a greater market orientation, helping to make U.S. farm commodities more competitive in the world marketplace while maintaining farm income. This success, however, has come at a cost much higher than that of previous farm bills. Between fiscal years 1986 and 1988, farm price and income support programs averaged over $20 billion annually.

Achieving Desirable Levels of Grain Stocks

Farm programs need to prevent the accumulation of unneeded surpluses and minimize USDA's costly acquisition, storage, and disposal of grain stocks.

Achieving a desirable level of grain stocks—the accumulated difference between production and use over time—has been a significant goal in the design of farm bills. The U.S. Department of Agriculture (USDA) influences the level of grain stocks through its price and income support and export subsidy programs. These programs have the effect of raising or lowering production and disposing of stocks when they become excessive. For example, price supports and target prices set above market clearing levels encourage farmers to produce more than the market will purchase. Acreage reduction programs offset these incentives and lower production. The government continually adjusts these programs to account for economic conditions, cost, weather, and other factors.

A desirable level of grain in government and private stocks was not defined in the 1985 farm bill. However, grain stocks were viewed as too high in 1985. Total U.S. wheat stocks ranged from about 46 to 97 percent of total annual use from 1984 to 1987; corn stocks as a percentage of annual use ranged from 23 to 66 percent over this period. By 1988, wheat and corn stocks had been reduced to less than 25 percent of annual use, and the 1988 drought has even raised the question of whether stocks are now too low.

While grain stocks are important sources of supply when harvests are poor, they can be costly to obtain and hold during times of surplus. The government's stock-related costs under the 1985 farm bill have been substantial:

- Net price support loans, which are potential costs to acquire stocks if farmers forfeit their collateral, jumped from about $6 billion in fiscal year 1985 to almost $14 billion in 1986 and over $12 billion in 1987.

- Storage and handling outlays have averaged about $1.8 billion between fiscal years 1986 and 1988, almost twice fiscal year 1985 levels.
- Commodity Credit Corporation export programs, which help dispose of stocks, cost an estimated $449 million in fiscal year 1988, up from $134 million in fiscal year 1985. Commodity certificates have helped the government to move stocks into the marketplace but have increased overall program costs. USDA has estimated that costs were $341 million, or 5 percent, higher in fiscal year 1987 because certificates were used.

To prevent excessive surpluses and minimize USDA's stock-related costs, alternatives to the current approach for achieving a desirable level of grain stocks should be considered. Some alternatives place greater reliance on private markets. Others strengthen federal control over commodity production and marketing.

Adding More Flexibility to Production Controls

Farm programs need alternative production controls that retain USDA's ability to influence crop production but provide farmers more flexibility to respond to market opportunities.

The 1985 farm bill moved farm programs in a more market-oriented direction. However, rigidities in the bill's production control provisions have discouraged farmers from producing certain crops, even when commercial market conditions are favorable.

To control production, federal farm programs require farmers to establish an acreage base for certain program crops as a condition for receiving benefits. The government has then limited planting of the program crops to a specified percentage of the base (which is called permitted acreage) and calculated payments generally on the basis of the land in production. Farmers have been discouraged from planting other crops on their permitted or idled acreage, because they would have lost eligibility for some future payments.

In 1988, these production control provisions affected the planting decisions of producers in the Corn Belt, who maintained their level of corn production and did not expand their soybean production, despite a soybean market that was strong relative to corn. In this case, reductions in corn acres would probably have lowered government costs for deficiency payments and corn acquisition and storage. Increases in soybean acres may have improved market returns for agriculture and tempered production expansion by foreign producers who compete with U.S. farmers in world markets.

In response to the 1988 drought, the Congress modified the law to allow farmers to plant, for example, soybeans on their permitted corn acreage in 1989 without losing their eligibility for future corn benefits. The 1990 farm bill debate should focus on such alternatives that retain USDA's ability to influence crop production but provide farmers more flexibility to respond to market opportunities.

Easing the Administrative Burden

The administrative burden on the Agricultural Stabilization and Conservation Service should be eased to achieve more effective farm programs.

The Agricultural Stabilization and Conservation Service's county office work load increased 38 percent between fiscal years 1985 and 1988. The county offices have had to administer many activities that were created or expanded by the 1985 farm bill, including additional yield payments, commodity certificates, the Conservation Reserve Program, the Dairy Termination Program, sod/swampbuster and conservation compliance provisions, new methods for determining crop acreage base and yields, marketing loans, payment limits, and increased loan-making and compliance activities.

To meet this challenge, the agency used 29 percent more permanent full-time staff years in fiscal year 1988 compared with fiscal year 1985. It also used 51 percent more temporary county staff years. County office salary and expense costs increased from about $317 million in fiscal year 1985 to $476 million in fiscal year 1988.

Even with increased staffing, agency officials have noted that the expanded responsibilities under the 1985 farm bill have been very difficult to implement. Many expressed their frustrations to us. For example, the administration of payments was called a "monster." We were told that the increased number and complexity of the 1985 farm bill programs resulted in a tremendous volume of forms, documents, and continual updates of regulations. In particular, paperwork for loans and deficiency payments, acreage compliance, and payment limitation justifications has caused problems. We were told that the Congress would be "shocked" at the administrative requirements for programs it authorizes.

The increased administrative burden likely has negatively affected the performance of Service employees in administering the programs. Recent USDA Office of Inspector General reports on Service operations have pointed out various problems. For example, local offices were found to have made numerous errors implementing the Dairy Termination Program, commodity certificates, commodity loans, crop acreage base calculations, and payment limits. Service officials have acknowledged that compliance checks and staff training have been shortchanged.

Reducing the Cost of FmHA Loan Programs

The Farmers Home Administration (FmHA) serves as a temporary source of credit for family farmers whose financial situations prevent them from obtaining credit elsewhere at affordable rates and terms. In this capacity, FmHA must balance the competing objectives of following sound lending practices that protect the government's and, ultimately, the taxpayers' financial interests with providing assistance to financially troubled farmers.

FmHA borrowers are obligated to repay their loans. However, of a total farm program loan portfolio of about $26 billion as of June 30, 1987, $7 billion in principal and interest due was delinquent on loans to about 83,000 borrowers with outstanding principal of $13.3 billion. About $5.7 billion of the $7 billion that is delinquent is owed by about 33,000 borrowers who have not made a loan payment in over 3 years.

FmHA borrowers are also expected to graduate to other credit sources as soon as they are financially able, as they receive significant benefits at a substantial cost to the government. For example, we estimated that in 1986 alone, the difference between the interest charged to FmHA borrowers and the government's interest costs for borrowing money to loan to

FmHA borrowers was between $0.6 billion to $1.6 billion.

Revising Loan-Making Criteria

FmHA could reduce program costs by implementing revised loan-making criteria that minimize the approval of loans that cannot be repaid and eventually result in the loss of borrower equity.

Because FmHA uses optimistic financial data in making cash flow analyses as a basis for approving loans, it often makes loans to farmers who are unable to make payments and have little chance of financial recovery. Such loans may provide temporary help, but frequently result in heavier debt loads and reduced borrower equity, which in the long run weakens the borrower's financial condition. This, in turn, exposes the government to significant financial losses. For example,

- as of June 30, 1987, annual direct loan losses in FmHA's major farm programs had grown from $41 million (fiscal year 1978) to $1.1 billion (fiscal year 1987), and
- in March 1988, FmHA estimated that resolving delinquent loan problems will cost $8.7 billion by fiscal year 1990—about $2.1 billion for debt reduction and about $6.6 billion for debt liquidation.

The Secretary needs to work with the Congress to implement a more comprehensive set of loan-making criteria that assess a borrower's financial solvency, profitability, liquidity, and repayment ability before making a new loan. This will improve the financial condition of FmHA's loan portfolio and assist borrowers by providing them with a more realistic assessment of their financial condition before they accept additional credit.

Helping Farmers Graduate to Alternative Sources of Credit

Specific criteria, such as time limits and measurable financial improvement, can help determine when a borrower has had a sufficient opportunity to become financially sound and graduate to non-FmHA sources of credit.

Most FmHA borrowers have not graduated to other sources of credit because they are not financially able to do so and because other lenders are reluctant to provide them credit. FmHA has financed many of its financially stressed farmers for extended periods because neither the Congress nor FmHA has identified criteria for determining how long FmHA should serve as a "temporary source of credit." The lack of criteria and various legislative, agency, and court actions have required FmHA to continue to finance even its financially weakest borrowers. As a result, about 112,000 of FmHA's 263,000 borrowers with active loans as of December 31, 1986, had continuously participated in FmHA farm loan programs for 7 years or longer. This includes 57,600 borrowers who had continuously stayed in FmHA farm programs for 10 years or more.

The Secretary needs to work with the Congress to adopt specific criteria, such as time limits and measurable financial improvement, to determine when a borrower has had sufficient opportunity to become financially sound and graduate to non-FmHA sources of credit. In doing so, they will have to decide at what point the cost of providing credit assistance to financially marginal farmers (including the cost of loan losses and interest rate subsidies) outweighs the benefits to the government, rural communities, and the farmers. For FmHA borrowers showing little potential for success, other forms of assistance, such as job training to help them obtain other types of employment, might be more appropriate.

Finding Long-Term Answers to Reduce the Dairy Surplus

Under existing dairy support price and marketing programs, the nation's farmers have produced much more milk than consumers have demanded. As a result, program costs have increased from $247 million (fiscal year 1979) to a high of $2.7 billion (fiscal year 1983). In fiscal year 1987, the government spent about $1.2 billion on surplus dairy products. Experts anticipate even greater increased milk production because of the wider use of existing technologies and the introduction of new technologies derived from biotechnology that are likely to increase the amount of milk cows can produce.

Curtailing Surpluses With Short-Term Solutions

Short-term solutions cannot be relied on to solve the long-term dairy surplus problem.

The Congress has attempted to curtail the milk surplus by authorizing short-term programs to reduce production incentives. For example, between January 1984 and March 1985, farmers were offered cash payments to reduce their milk sales by 5 to 30 percent through the Milk Diversion Program. Of the nation's 200,000 commercial milk producers, 38,000 participated in the program. Although this effort temporarily slowed the increase in milk production and subsequent sales to the federal government, milk production in 1985 increased by nearly 6 percent over 1984.

Under the Dairy Termination Program, the Congress attempted to curtail production by persuading farmers to eliminate their herds. Between April 1986 and September 1987, farmers participating in the program were paid to slaughter or export their entire dairy herds, and they agreed not to reenter dairy farming for at least 5 years. Dairy production has leveled off since this program was implemented.

USDA will not be able to rely on such programs to reduce long-term dairy surplus problems. The Milk Diversion and Dairy Termination programs, although effective in the short term in reducing production, do not address the long-term implications of overproduction. Dairy production will eventually rise as these programs' effects diminish.

Developing a Long-Term Strategy to Curtail Surpluses

A strategy is needed for addressing the long-term dairy surplus problem. This strategy could entail a greater reliance on market forces and a decreased federal role in dairy production.

Both the milk marketing order and support price programs have historically provided farmers incentives to produce more milk than can be sold. Milk marketing orders, for example, contribute to excess production and are no longer needed to assure adequate supplies of milk. The support price program contributes even more to creating surpluses than marketing orders.

The Congress provided farmers incentives to produce less milk by applying a supply-demand adjuster to the milk price support. Using this adjuster, the Secretary of Agriculture adjusts the milk support price annually to encourage smaller surpluses. Although the supply-demand adjuster could provide longer-term management of dairy production, it has not been allowed to operate freely. Because of the drought, the Congress overrode the expected January 1989 reduction in the price support level to support dairy farmers' income.

Alternatives to milk marketing orders and price supports—if such alternatives substantially restructure the milk-producing industry—can have significant implications. For example, dairy industry deregulation could eventually ensure an adequate supply of milk while protecting farm income, but in the near term it would be likely to destabilize the industry and financially hurt some dairy farmers and processors. To help the industry during the transition to a market economy, the government should implement policies incrementally to allow time for the dairy industry to adjust and for the government to monitor such adjustments to assure that unanticipated adverse effects do not occur.

Other policy options that would manage supply with price incentives could also be considered. For example, a moving-average price, which would establish the support price as a designated percentage of milk's average market price over some preceding time period (such as the preceding 3 years), might also effectively curtail supply.

Strengthening the Financial Viability of the Federal Crop Insurance Program

Since 1938, the Federal Crop Insurance Corporation (FCIC) has promoted agricultural stability by offering farmers crop insurance to protect against crop damage and destruction caused by nature. Since its mission was expanded in 1980, FCIC has encountered chronic operational and financial difficulties. FCIC has been unable to achieve a high level of program participation, negotiate equitable terms with private sector brokers selling and servicing its insurance, and operate in a fiscally or actuarially prudent manner.

Undermining FCIC's Financial Viability

Benefits from competing disaster assistance programs should be eliminated or made conditional upon participation in the crop insurance program.

Competing disaster assistance programs undermine the financial viability of the federal crop insurance program by lowering participation rates. In times of disaster, such as the 1986 and 1988 droughts, the Congress and administration have provided disaster payments and subsidized loans to both insured and uninsured farmers, which creates the perception that insurance is unnecessary. Farmers' expectations that the federal government will provide direct payments or subsidized loans in times of disaster may contribute to the relatively low participation in the insurance program. Farmers insure only about 25 percent of eligible crop land with federal crop insurance.

Eliminating competing disaster assistance programs or permitting the receipt of such benefits only upon participation in the crop insurance program could help FCIC expand program participation, which would help it to operate on a more actuarially sound basis. This is particularly significant in view of FCIC's deteriorating financial condition. Since 1981, insurance claims have exceeded premiums by about $1 billion, and FCIC's continued viability has been questioned.

Reestablishing Controls Over Private Companies Selling Crop Insurance

To prevent its financial condition from deteriorating further, FCIC must exercise better control over private companies selling and servicing crop insurance and review its standard reinsurance agreements with these companies.

FCIC relinquished many fiscal and programmatic controls in the 1980s as private brokers gradually replaced government insurance brokers. Private insurance companies, which are reinsured by FCIC, now sell and service most crop insurance. Until 1986, FCIC exercised virtually no oversight over the activities of the reinsured companies—even though it was paying for most of the losses they incurred. As a result, it overpaid millions of dollars in insurance claims because it failed to oversee private companies' adjustment activities. FCIC has begun to improve its control over reinsured companies, but more remains to be done.

FCIC's standard reinsurance agreements with private companies may not provide sufficient financial incentives to use federal funds responsibly. The contract provisions appear to favor the reinsured companies and could be contributing to FCIC's current financial difficulties. For example, FCIC made errors in setting the initial sale and servicing reimbursement rates in 1981, which may have inflated these rates, and did not correct the errors in subsequent agreements. In addition, FCIC's revisions to its agreement with reinsured companies for sharing insurance gains and losses shift much of the program's financial risk to the federal government. These revisions may also reduce the reinsured companies' incentives for protecting federal funds and thus increase the government's expenses substantially.

Questions have been raised about whether the current system of selling and servicing insurance through reinsured companies is, over the long term, in the government's best interest. Under one alternative approach, these companies could continue to sell policies while FCIC would adjust insurance claims. This arrangement could reduce program losses since FCIC, as the reinsurer, would have a greater incentive to adjust claims prudently.

Enhancing U.S. Agricultural Competitiveness

The United States, faced with strong competition since the early 1980s, can no longer rely on foreign markets as willing recipients of its surplus products. Success in today's world market requires (1) U.S. agriculture to develop innovative marketing strategies built on a reputation as a reliable supplier of the products customers want and (2) USDA to more effectively manage its export promotion and foreign market development programs.

Using Marketing Strategies to Increase Exports

To compete effectively in world markets, federal, state, and private officials must shift from a production-related approach that relies on the export of surplus crops to a market approach focused on identifying customer needs.

Developing strategies for increasing exports has become more difficult as the U.S. food and agriculture system has become more integrated into the increasingly competitive world agricultural marketplace. Failure to adapt to the changes in the world market can result in lower exports. This happened in the early 1980s, when U.S. agricultural exports declined faster and further than those of most other exporters during a general decline in total world agricultural trade.

To adapt better to changing world markets, federal, state, and private officials must apply strategic marketing principles by shifting from a production-related approach that relies on the export of surplus crops to a market approach focused on identifying customer needs. Many foreign competitors have adopted the market approach, which has allowed them to capture market niches in the United States and elsewhere.

In addition, U.S. agricultural exports could be increased by satisfying customer demands for higher quality products, emphasizing the sale of high-value products that currently exceed traditional bulk commodities as a percentage of world agricultural trade value, and targeting opportunities for market growth in third world countries. The federal government could help increase exports by lessening domestic and foreign policy constraints to trade, continuing to call within the current General Agreement on Tariffs and Trade negotiations for the elimination of all agricultural subsidies and import barriers that distort trade, and increasing the flexibility of federal policies and programs to enhance international competitiveness. The administration should also encourage a greater focus on marketing in our universities, research centers, and government agencies.

Improving Management Control Over Export Programs

The Foreign Agricultural Service must exercise greater management control over export programs—including preparing better funding criteria, written guidelines, and evaluation methodology—to improve U.S. agricultural export performance.

USDA's Foreign Agricultural Service, which administers foreign market development and export enhancement programs, typically seeks to achieve its objectives by subsidizing private sector efforts. By using a hands-off management approach, however, the Service spent about $7 billion for agricultural export programs in fiscal year 1988 without adequate planning, evaluation, and accountability.

The Service's laissez-faire approach has raised concerns about the effectiveness of the Cooperator Market Development Program, under which the Service provides federal funds to private, nonprofit agricultural organizations to develop and expand export markets. Although the Service expended nearly $40 million in fiscal year 1986 for the program, it was not effectively evaluating the program's results because of inadequate evaluation methodology. Consequently, the Service needs to develop this methodology to have enough information to determine which market development activities were effective and which needed to be refined or terminated.

The effectiveness of the Targeted Export Assistance Program, which was established to offset the effect of unfair trade practices on U.S. agricultural exports, is also questionable. Although the Service had a minimum of $110 million to allocate in fiscal year 1987, it did not adequately document its funding decisions to ensure that funds were allocated equitably among qualified applicants. The Service will need to exercise greater management control to improve funding decisions to ensure effective and efficient program operations and prevent potential abuse.

The Service has also ineffectively managed the Export Enhancement Program, which is designed to allow U.S. agricultural commodities to compete against subsidized competition. Among other actions, the Service needs to better document its determinations of minimum sales prices and maximum bonus amounts. Management improvements are also needed in the Service's export credit guarantee programs—which provide credit guarantees for U.S.

exporters that sell U.S. agricultural products on credit—to ensure that outstanding guarantees are accurately accounted for and that U.S. agricultural commodities are being purchased with the guarantees provided.

Improving the Delivery of Food Stamp Benefits

In 1977 the Congress established a quality control system to assist states in ensuring the accurate delivery of Food Stamp Program benefits to all eligible participants. Dissatisfied with the states' performance under this system, the Congress added a sanction process in 1980 that assessed financial penalties against states providing recipients with incorrect benefit amounts. Since 1983, the penalties have been based on the difference between the rate by which a state overpaid benefits (overpayments) and an established allowable error rate. Accurate benefit delivery remains a problem, however, and many critics of the sanction system have called for reform.

Reforming the Food Stamp Sanction System

Recent legislation should address some of the problems related to the delivery of food stamp benefits. However, additional legislative and administrative actions may be needed to further improve the effectiveness and accuracy of the food stamp sanction system and to resolve unpaid sanctions owed to the federal government.

Since the Congress established the food stamp quality control and sanction systems, states have reduced their overpayment rates on average from about 10 percent (1981) to about 8 percent (1987), never coming close to meeting the 5-percent threshold established by law for fiscal years 1985 and beyond. As a result, almost all states have been sanctioned, with 49 states accumulating penalties of more than $500 million since fiscal year 1981.

States have challenged the fairness and reliability of the sanction system, administratively and in court, and have thus far paid less than $1 million in penalties. Among the problems cited by states and us are the following:

- Error-rate measurements are unreliable because small sample sizes have led to unacceptably large sampling errors.
- Quality control methodology, although statistically valid, could be improved with better guidance and procedures.
- Very small differences in error rates, which generally are not precise because of large sampling errors, can cause disproportionate differences in state sanctions.
- Legislated error-rate thresholds, which have been set at 5 percent since fiscal year 1985, are arbitrary, because they are not based on empirical study, and unrealistic, because states have so often been unable to achieve them. Nevertheless, because the sanction amounts are so high, states have emphasized reducing overpayments at the

expense of reducing underpayments, improper denial or termination of benefits, and other activities that are not sanctioned under the quality control system.

In August 1988 the Congress passed reform legislation that eliminates sanctions for states whose performance is better than average and includes underpayments along with overpayments in calculating a state's error rate. It also bases sanctions on benefits paid instead of federally reimbursed administrative costs; streamlines the lengthy and costly sanctions appeal processes that states must follow; eliminates the incremental method for calculating sanctions, which causes small differences in error rates to result in large differences in sanctions; and refines the federal and state quality control methodology used to measure payment accuracy and levy state sanctions.

Further legislative and administrative actions may be needed to address other reforms, including (1) the use of additional factors in determining error rate sanctions, such as the improper denial or termination of food stamp benefits; (2) improved error-rate accuracy; and (3) redefined federal and state roles for administering the quality control system. Further action may also be needed to address how to resolve much of the accumulated unpaid sanctions that states owe but have not paid to the federal government.

Improving Benefit Delivery

The Food and Nutrition Service should undertake a number of administrative reforms to ensure that benefits are delivered efficiently and fairly.

Some additional issues requiring continued management attention to improve the efficiency and fairness of benefit delivery are

- eliminating administrative hindrances that prevent or delay eligible households from applying for and participating in the Food Stamp Program;
- assuring that states have and use consistent instructions and procedures to record and report data on food stamp applications, which will ensure that USDA uses accurate data to evaluate state performance;
- ensuring that benefit losses to eligible participants as a result of improper denials or terminations from the program are minimized;
- monitoring federal resources used for food stamp automation to assure that automated systems are used effectively for

improving the delivery of program benefits and administration and reducing fraud, waste, and abuse; and

- reviewing the adequacy of internal controls used to ensure that ineligible people are deterred from participating in the program.

Related GAO Products

Farm Programs	Farm Programs: An Overview of Price and Income Support, and Storage Programs (GAO/RCED-88-84BR, Feb. 29, 1988).
Farmers Home Administration	Farmers Home Administration: An Overview of Farmer Program Debt, Delinquencies, and Loan Losses (GAO/RCED-86-57BR, Jan. 2, 1986). Farmers Home Administration: Financial and General Characteristics of Farmer Loan Program Borrowers (GAO/RCED-86-62BR, Jan. 2, 1986).
Dairy Surplus	Dairy Termination Program: A Perspective on Its Participants and Milk Production (GAO/RCED-88-157, May 31, 1988). Milk Marketing Orders: Options for Change (GAO/RCED-88-9, Mar. 21, 1988). California Dairy: Production, Sales, and Product Disposition (GAO/RCED-88-180FS, June 15, 1988).
Crop Insurance	Crop Insurance: Overpayment of Claims by Private Companies Costs the Government Millions (GAO/RCED-88-7, Nov. 20, 1987). Crop Insurance: Federal Crop Insurance Corporation Needs to Improve Decisionmaking (GAO/RCED-87-77, July 23, 1987).

Exports	Opportunities to Improve U.S. Food/Agricultural Exports Through Improved Marketing Techniques (GAO/T-RCED-88-56, June 28, 1988). Agricultural Competitiveness: An Overview of the Challenge to Enhance Exports (GAO/RCED-87-100, May 7, 1987).
Food Stamps	Food Stamp Program: Error Rate Adjustments and Sanctions (GAO/RCED-88-10, Oct. 22, 1987). Food Stamp Program: Evaluation of Improper Denial or Termination Rates (GAO/RCED-88-12, Oct. 22, 1987).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

United States General Accounting Office

GAO

Transition Series

November 1988

Justice Issues

GAO/OCG-89-13TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Attorney General-designate

This summary report is one of a series that addresses major policy, management, or program issues facing Congress and the new administration. This report discusses issues, the problems associated with each, and recommended actions based on our work at the Department of Justice. Some of our concerns are relatively new, while others represent unresolved problems that have developed over the past several years.

The four issues we believe should be included in whatever agenda Congress and the Attorney General set for the Department of Justice are (1) improving overall departmental management, (2) reassessing the effectiveness of drug abuse control programs, (3) planning for the potentially staggering costs of sentencing reform, and (4) determining whether immigration reform is working. We studied the management of the Department of Justice and reported to Congress in 1986 that the Department's central management needed strengthening. In 1988 we issued a special status report on controlling drug abuse that provided an overview of the drug problem and federal efforts to deal with it. All four issues are fully discussed in the reports noted at the end of this report.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Strengthen the Department's Central Management Capability 4

Develop Information Needed to Set Budgetary Priorities for Anti-Drug Programs 7

Identify Effects of Sentencing Reform 10

Determine Whether Immigration Reform Is Working 14

Increase Efforts to Prevent Discrimination Due to Immigration Reform 16

Related GAO Products 17

Transition Series 19

Strengthen the Department's Central Management Capability

Effective management of the Department of Justice's 71,000 employees and $5.4 billion budget is complicated by its highly decentralized operations and the operating freedom and independence afforded to many of its agencies and offices. Lack of central management has contributed to problems in planning and implementing program initiatives. The Department needs to strengthen its central management capability to ensure that effective management systems are in place to support the many policy, priority, and resource decisions the Attorney General must make.

The need for strong central management is demonstrated by problems the Department has encountered in managing defense procurement fraud investigations. Even though these investigations were a top Attorney General priority, the Department's overall management of these investigations shows a lack of planning and program management capability.

The Department does not have complete or timely information on the status of a significant number of defense procurement fraud cases and does not know the amount of attorney resources spent on this high priority program. Moreover, its prosecuting offices have not developed written management plans outlining current and future efforts in this area that could be used for assessing performance and problems. The Department needs a process for developing and periodically updating written plans that contain goals to provide a mechanism for assessing performance and problems in the Attorney General's law enforcement priorities.

Various Department officials, including former Attorneys General, have recognized the need for stronger departmental management. Past Attorneys General traditionally have looked to the Deputy Attorney General to serve as the Department's general manager. This has seldom been fully satisfactory, in part because the Deputy has had responsibility for both management matters and general supervision of criminal or civil matters. These litigation responsibilities often have sapped much of the Deputy's time and attention, to the detriment of improving overall departmental management.

In 1987, the Attorney General attempted to strengthen overall departmental management by seeking congressional approval to assign management responsibility to the Deputy Attorney General and relieve him of his litigative responsibilities by creating a two-Associate Attorney

General system for supervising the Department's civil and criminal matters. However, Congress did not act on this proposal.

A fundamental decision the next Attorney General must make is how to strengthen central management of the Department. The Department must deal with a number of critical, complex issues such as drug abuse control and reforms to sentencing and immigration laws. A strong central management structure will enable the Attorney General to successfully meet these challenges and should pay lasting dividends, not only for the next administration, but over the long term.

Develop Information Needed to Set Budgetary Priorities for Anti-Drug Programs

If we measure success of the current federal drug abuse control strategy by looking at the number of drug users and amounts of drugs entering the country, we must unfortunately conclude that our present strategy—which emphasizes supply reduction—is not very effective. The dilemma is that no one knows which drug control programs are the most effective.

An increasing number of drug experts believe that the root cause of our national drug problem is the demand for illegal drugs. It is time to consider assigning more resources to activities aimed at reducing demand: treatment, prevention, education, and research on the causes and extent of drug abuse. This does not mean that efforts to control the supply of illegal drugs should be reduced. They play an important role in the overall drug abuse control strategy. However, further emphasis on supply reduction programs will probably not solve the drug problem in this country.

Recognizing the need to redirect the federal drug abuse control strategy, on October 22, 1988, Congress passed the Anti-Drug Abuse Act of 1988. The legislation, among other things, establishes in the Executive Office of the President an Office of National Drug Control Policy, to establish and coordinate policies, objectives, and priorities for federal antidrug abuse efforts. The legislation also provides for greater emphasis to programs aimed at reducing the demand for illegal drugs.

Setting budget priorities will be a key responsibility of the Director of the new Office of National Drug Control Policy. To help accomplish this task, the Director will need better information on program effectiveness to decide where resources should be allocated. In the past, the National Drug Policy Board, chaired by the Attorney General, did not use its statutory authority to develop budgetary priorities, on the grounds that it lacked the information needed to decide where resources should be allocated.

Existing data systems portray drug trends and help gauge the overall impact of the federal strategy but do not adequately measure the effectiveness of specific drug control efforts. Measuring effectiveness is difficult. First, it is difficult to isolate the full impact and effectiveness of a single program such as drug interdiction. Second, the clandestine nature of drug production, trafficking, and use limits the quality and quantity of data that can be collected to measure program success. Third, the data that are collected—for example, the data used to prepare estimates of drug availability and consumption—are generally not designed to measure program effectiveness.

The new legislation also requires the development of measurable objectives for antidrug abuse programs. The Attorney General should work with the Director of the new Office of National Drug Control Policy, to develop effectiveness measures for Justice programs. Such measures would provide information that Congress and the executive branch need to make informed decisions about the allocation of budget resources to drug abuse control programs.

We have addressed the drug control issue more fully in *Controlling Drug Abuse: A Status Report* (GAO/GGD-88-39, Mar. 1, 1988).

Identify Effects of Sentencing Reform

The federal criminal justice system has taken a significant turn in recent years toward stiffer and more consistent sentences for criminals. From a Department of Justice perspective, the budgetary consequences of this reform could be staggering and the Department must develop cost estimates and evaluate alternatives to ensure that the best resource decisions are made. Prison construction costs alone could reach $4.6 billion during the next 9 years.

The Comprehensive Crime Control Act of 1984, the Anti-Drug Abuse Act of 1986, and the sentencing guidelines established in 1987 by the U.S. Sentencing Commission reformed sentencing practices by significantly increasing prison sentences for certain federal offenders. While the actual impact of sentencing reform is just now emerging, the potential impact over the next several years is enormous in terms of the increased work load of federal prosecutors, U.S. Marshals, and other court personnel, and the potential increase in the federal prison population.

Under sentencing reform, criminals who face stiffer sentences may not agree to plead guilty and instead choose to go to trial. For the year ending June 30, 1986, about 86 percent of convicted defendants pled guilty rather than go to trial. If the plea agreement rate decreases significantly, there will be a need for more prosecutors, marshals, and other court personnel to handle the increased work load. Neither the judicial branch nor the Department of Justice has developed estimates of the budgetary impact of sentencing reform on plea agreements.

There is no doubt, however, that considerable resources will be needed to provide effective custody, care. and rehabilitation programs for expected increases in the Department's prisoner population. Prison overcrowding could become a major impediment to an effective federal criminal justice system if sufficient funds for prison expansion are not provided or alternatives to construction are not fully used.

As of July 1988, federal prisons housed about 43,100 prisoners, 57 percent more than the prisons are designed to handle. Another 6,800 prisoners were housed in contract facilities. The U.S. Sentencing Commission estimated that the federal prison population will be between 78,000 and 125,000 prisoners by 1997. Only a small portion (about 5 to 6 percent) of the increase will be due to the sentencing guidelines. Thus, even if ongoing constitutional challenges to the guidelines are successful, the prison population will still increase substantially due to the increased sentences required by the 1984 and 1986 acts.

The Department ultimately wants to reduce its prison overcrowding to 20 percent over capacity. To accomplish this goal and to provide for the additional prisoners, the Department would need about $2.0 to $4.6 billion (excluding inflationary impacts) to construct new prisons unless other alternatives are used. The Department may need another $0.5 to $1.0 billion a year to operate and maintain the new prison space.

The Department needs to ensure that alternatives to new prison construction, such as excess military facilities, halfway houses, or "private contract facilities," are used where feasible. Joint ventures with the military or some state prison systems need to be considered. Where possible, minimum security facilities should be used in lieu of higher security facilities that are more costly. Also, limited funds may make larger capacity prisons more palatable to the corrections community than the current practice of limiting prison capacity to 800 or fewer beds. Prison "boot camps" (military style prisons oriented toward discipline), "electronic supervision," probation with varying degrees of supervision, or other innovative alternatives to traditional incarceration also need to be evaluated.

The Attorney General must ensure that the cost implications of sentencing reform are thoroughly examined. Budgetary limitations will require that only the most efficient and effective programs are implemented.

Determine Whether Immigration Reform Is Working

To reduce the flow of aliens illegally entering the United States to find work, Congress passed the Immigration Reform and Control Act of 1986 (IRCA) which, among other things, prohibits employers from hiring any alien not authorized to work. The primary tool provided by IRCA to stop the hiring of aliens not authorized to work is the employer sanctions provision of the act which provides civil and criminal penalties for employers who do not comply with the law.

It is now unlawful to knowingly hire aliens not authorized to work or to hire any person (including U.S. citizens) without verifying the person's legal employment status. All employers need to certify that each new employee hired is authorized to work. This provision applies to each of the nation's estimated 7 million employers and the 67.5 million people hired annually.

IRCA is consuming about a fourth of Justice's Immigration and Naturalization Service's (INS) resources, often at the expense of other programs. It also places a burden on the nation's employers and employees. These costs are in vain if IRCA does not achieve its objective of preventing the employment of illegal aliens.

Determine Whether Immigration Reform Is Working

The Attorney General must be in a position to tell Congress if the act's objectives of reducing illegal alien employment and flow into the country have been met. To do this, he must ensure that INS collects and analyzes the right information for assessing the effectiveness of the act.

INS will need to modify its data collection and analyses regarding aliens' employment activities. For example, to determine the act's impact on reducing unauthorized alien employment, INS needs to systematically collect and analyze information about whether unauthorized aliens were employed before or after implementation of the act.

However, INS is not always determining when the unauthorized aliens were employed. As a result, the Attorney General will not know how the employment of unauthorized aliens changed after implementation of the act. In addition, the Attorney General needs to know the extent that aliens use fraudulent and counterfeit documents to circumvent the act.

Increase Efforts to Prevent Discrimination Due to Immigration Reform

IRCA allows Congress to use expedited procedures to repeal the employer sanctions provision if it causes a widespread pattern of employment discrimination. The law also establishes a new enforcement unit in the Department of Justice to investigate complaints—the Office of Special Counsel for Immigration-Related Unfair Employment Practices (OSC).

As of September 12, 1988, OSC had received 279 discrimination complaints. Information from employers indicates that there may be many more employers who are discriminating against foreign-looking persons, which is not permitted under the act.

To help prevent employer discrimination, the Department needs to increase its efforts to educate employers on their rights and responsibilities under the act. If the employer sanctions provision is repealed because of employer discrimination, then a major tool for preventing illegal immigration would be lost.

Related GAO Products

Justice Department: Improved Management Processes Would Enhance Justice's Operations (GAO/GGD-86-12, Mar. 14, 1986)

Controlling Drug Abuse: A Status Report (GAO/GGD-88-39, Mar. 1, 1988)

Sentencing Guidelines: Potential Impact on the Federal Criminal Justice System (GAO/GGD-87-111, Sept. 10, 1987)

Immigration Reform: Status of Implementing Employer Sanctions After One Year (GAO/GGD-88-14, Nov. 5, 1988)

Defense Procurement Fraud: Justice's Overall Management Can be Enhanced (GAO/GGD-88-96, June 29, 1988)

National Drug Policy Board: Leadership Evolving, Greater Role in Developing Budgets Possible (GAO/GGD-88-24, Feb. 12, 1988)

Drug Abuse Prevention: Further Efforts Needed to Identify Programs That Work (GAO/HRD-88-26, Dec. 4, 1987)

Drug Control: U.S. International Narcotics Control Activities (GAO/NSIAD-88-114, Mar. 1, 1988)

Drug Control: Issues Surrounding Increased Use of the Military in Drug Interdiction (GAO/NSIAD-88-156, Apr. 29, 1988)

Drug Smuggling: Large Amounts of Illegal Drugs Not Seized by Federal Authorities (GAO/GGD-87-91, June 12, 1987)

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

United States General Accounting Office

GAO

Transition Series

November 1988

Veterans Affairs Issues

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Secretary-designate of Veterans Affairs

This report highlights important issues identified through our work over the past several years that affect the nation's ability to deliver effective and equitable services to its veterans. The four issues that we believe should be included in the agenda the Congress and the Secretary set for the new department are (1) improving overall departmental management, (2) planning to meet the long-term care needs of a burgeoning population of aging veterans, (3) reassessing the schedules used to set compensation levels for disabled veterans, and (4) modernizing information systems.

VA has begun to take steps to address these issues. A new Secretary of Veterans Affairs will need to direct efforts to improve the overall management of the medical and benefit programs and thereby enhance the delivery of services to the nation's veterans.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Managing Program Operations 4

Serving Veterans' Long-Term Care Needs 9

Compensating Veterans' Disabilities 15

Modernizing Information Systems 18

Related GAO Products 21

Transition Series 23

Managing Program Operations

Assuring Quality of Field Facilities' Services

After years of debate, the Congress voted to elevate the Veterans Administration to cabinet status. Long-time supporters of this change expect that it will lead to higher quality services for the nation's veterans. The new Secretary will be judged, in large part, on how well these expectations are met.

Improving the quality of VA's services will be a challenge because VA provides medical and compensation services through a network of 172 medical centers and 58 regional benefit offices located throughout the country. In such an environment, a decentralized approach to management is appropriate. But such an approach makes it essential that systems are in place to enable managers at headquarters to determine whether field facilities are providing quality services.

Over the years, our work has identified many instances where VA's systems did not provide this kind of key information. We believe this occurred because VA had not

- determined what information was needed to assess service quality and established reporting requirements that would provide the needed information or

- followed through to assure that field facilities were complying with established information reporting requirements.

For example, we found that medical centers were not reporting, through appropriate quality assurance systems, most of the more serious patient injuries at the centers. In addition, managers at headquarters were not using the information they did have to detect the underreporting. Also, we found that one-third of the medical centers with surgical residents were not submitting the required reports on their supervision. As a result, headquarters' managers did not know that supervision at many centers was inadequate.

We reviewed VA's agent orange examination program and found that headquarters' managers had not asked for (and were not receiving) the information they needed to realize that they had serious problems in service quality. Managers required facilities to report the number of examinations performed and the number pending, but neglected to collect data on how long veterans had to wait for appointments. Thus, managers could not tell from the reports which facilities were having problems with timely service delivery.

We also found instances where managers at headquarters did not take appropriate action to improve field facilities' services despite having information suggesting the need for such action. For example, several cardiac surgery centers reported mortality rates above VA's standard. However, VA managers did not take appropriate steps to determine why these centers were not performing at an acceptable level.

While most of GAO's work has focused on the quality of services at VA's medical facilities, the House Committee on Government Operations recently reported on VA's system for measuring the performance of VA's 58 regional benefit facilities. The Committee found that managers did not have adequate information to effectively monitor the facilities' processing of veterans' benefit claims. The limited work we have done in this area generally supports the House Committee's report.

VA has taken some steps to get better information on the quality of services at field facilities. But the Secretary needs to assure that these efforts continue and that managers at headquarters have and use systems that will provide sufficient information to assess quality.

Improving Efficiency of Medical Centers

As budget pressures grow, VA must also continue to look for ways to provide quality services to veterans more efficiently. Toward this goal, in 1985, VA initiated a resource allocation methodology designed to provide a financial incentive to medical centers to improve their efficiency and productivity. However, this new approach cannot realize its full potential without improved medical cost accounting systems. Under the new approach, VA allocates a portion of a medical center's budget based on the ratio of its total annual workload to its expenditures. The centers are to compete against each other and transfer money, through VA's budget process, from the less efficient centers to the more efficient ones.

While the goal is good, unfortunately VA's systems do not provide the types of information that medical center managers need to identify inefficient processes. For example, medical centers are credited a specific amount for each type of illness they treat but do not have information about their actual costs of treating any specific patient or illness. Although centers can generate cost estimates, they are sometimes inaccurate. Without accurate information on the costs of producing individual components of its total workload, VA's centers have limited capability to identify ways to control costs and, thereby, improve their cost-effectiveness.

VA has efforts now in process to improve the reliability of both clinical and financial data needed to support the methodology. They include installing new medical information systems and adopting a decentralized cost accounting system. Completion of these two efforts is critical if the resource allocation methodology is to achieve its goal of improving the efficiency of operations.

Serving Veterans' Long-Term Care Needs

Providing high-quality services efficiently requires that VA continually monitor the appropriateness of the size, condition, and location of its vast network of facilities. Because of current demographic trends, planning for long-term care facilities will assume increased importance over the next few years. In particular, VA needs to analyze more systematically the relative costs and benefits of the different long-term care options available to it, assure that it will have sufficient access to facilities operated by state governments and private sector firms, and do a better job of assessing the particular needs of the veteran population.

Planning to Meet Increased Demand

The number of veterans 65 years old and over increased from 3 million in 1980 to 6 million in 1987; it is expected to reach 9 million by the year 2000. The number of veterans with the greatest need for long-term care, those 75 years old and over, is expected to grow even more rapidly. Most veterans are eligible to receive long-term care from VA. A major task facing VA is determining how to deal with the projected increase in demand; decisions will have to be made soon because it can take, on average, 8 years to plan, design, and build a new facility.

VA does not know the relative cost of obtaining long-term care services through the different nursing home options it has available. VA has three alternatives: (1) facilities it owns and operates, (2) private community facilities with which it contracts, and (3) veterans' homes operated by states. VA determines its average daily expenditure for each alternative, but the results are not comparable because all costs are not included for each option.

VA's accounting and information systems are intended to capture all direct and indirect costs of care provided in its nursing homes. These costs include depreciation on the physical plant and costs of medical services for veterans residing in the homes. Given the current state of its systems, VA does not have reliable information on its medical care costs.

For its comparisons, VA includes only the daily stipends that it pays to the state and private facilities for each veteran residing in the facilities. However, many other costs are not considered, including the federal share of state home construction, VA pension costs, and some medical care.

In order to plan effectively to serve the needs of an aging veteran population, VA needs to analyze the relative costs of each of the options available to it for supplying nursing home care.

Current projections suggest that the number of veterans in need of long-term care will peak and then decline before the baby boom generation reaches the age of greatest dependency on long-term care. In fiscal year 1987, VA revised its planning goals to emphasize greater reliance on community and state veterans' nursing homes. Analyses of the kind discussed previously must be performed before we can know whether the particular allocation among the three different alternatives that are now being planned is the most cost-effective one. But based on what we currently know about the expected demographic pattern nationwide, it makes sense for VA to limit the amount of capacity added in its own facilities.

No matter what degree of reliance is placed on each of the three alternatives, VA will have to make substantial use of community facilities. Therefore, VA must take steps to assure that its plans for increased reliance on facilities it does not own prove to be realistic from a regional perspective. Many factors affect the availability of community nursing home beds. Although high nationwide, nursing home occupancy rates vary substantially from place to place. In some areas it may not be realistic to expect that VA can gain access to additional private sector capacity, whereas other areas may have plenty of room. Regional variation in nursing home vacancy rates needs to be taken into consideration in VA's planning.

Even if the supply in a given community is expanded, VA may not get access to the new beds because of disincentives for community nursing home operators to accept VA-supported patients. These disincentives include administrative burdens and VA length-of-stay limitations. To help assure the availability of beds, VA should begin now to outreach to community nursing home operators and make acceptance of VA-supported patients as desirable as possible.

Also, several factors hinder expansion of beds in state veterans' homes, including the availability of federal and state funding to construct and expand them and the length of time required to develop, approve, and fund individual projects. While VA can fund up to 65 percent of the cost of a state home, states must approve funding for a project before VA can request federal matching funds. To date, 20 states have not approved any funds for state homes. VA must encourage states to increase their participation and decrease the length of time from project development through the approval process to the actual funding.

Assessing Veterans' Nursing Home Needs

While the availability of beds in community and state veterans' homes is critical, increased reliance on such homes depends to a large extent on their ability to meet veterans' medical and nursing needs. VA assumes that all patients can be treated in any type of VA-supported home. In addition, VA does not identify the specific services that homes are to offer. Although the missions of VA-owned, community, and state veterans' homes are similar (all are intended to provide needed skilled or intermediate nursing care), the specific medical services available at individual facilities vary.

In 1986, we reported that VA lacked a management information system that collects comparable data on the medical conditions and nursing needs of all patients in VA-owned, community, and state homes, such as severity of illness, types and frequency of services needed, and levels of care required. To effectively plan for the types of facilities needed, VA should determine the nursing home needs of its current and future patient populations and match these needs with the varying capabilities of the facilities in each medical district or each medical center's primary service area.

Compensating Veterans' Disabilities

VA pays about $8.4 billion in compensation benefits to 2.2 million veterans disabled by injuries or diseases that were incurred or aggravated while in the military service. But to do this, it uses an outdated disability rating schedule that was developed over 40 years ago. This schedule must be reviewed and updated if VA is to give fair and uniform treatment to disabled veterans.

VA uses its rating schedule to convert medical findings on a veteran's condition to a percentage of disability. The rating schedule is divided into 14 sections representing the various body systems and lists about 720 medical conditions that veterans may be compensated for. The schedule is used to assign each condition a percentage rating that represents the average loss in earnings capacity the veteran can be expected to experience because of the disability. The percentage of disability determines the amount of the veteran's compensation.

VA is required by law to update the rating schedule periodically to reflect medical advances in the treatment of disabilities and diseases. VA has made some revisions to the schedule over the years, but many medical advances have not been recognized. Since 1978, 4 of the 14 ratings schedule sections have been updated, but 10 have not. The entire rating schedule has not been comprehensively updated since 1945.

GAO asked medical school physicians to review aspects of the current schedule and asked physicians at VA and the Department of Defense, as well as VA rating specialists, for their views of the current schedule. All groups responded that substantial improvements are needed. They cited examples of outdated terminology, as well as medical conditions that should be added. The VA physicians believe that all sections of the schedule need improved medical criteria. We believe that, as a result of this situation, VA cannot assure that veterans are receiving the correct amounts of compensation. Because the criteria are often needlessly vague and outdated, a particular veteran may be getting too little or too much and two veterans with the same condition may be compensated differently.

Fair and equitable adjudication of disability cases is a difficult task under the best circumstances; achieving equity becomes nearly impossible with an outdated rating schedule. Therefore, the rating schedule should be comprehensively reviewed and updated as appropriate to reflect medical advancements so that VA can better ensure that disabled veterans are fairly and equitably compensated.

Modernizing Information Systems

Clearly, major improvements both in the quality of VA services and in the efficiency with which they are provided depend heavily on VA's managers being able to get the right information at the right time. To help achieve this objective, VA has embarked on major systems modernization and integration efforts for both its medical and benefit programs.

We believe that the current program to modernize the medical information systems should continue, but both GAO and the Office of Technology Assessment have urged VA to undertake a major reassessment of this program before making another substantial investment. With respect to the benefit programs, GAO has also urged VA to continue to support the full implementation of the long-range information management plan.

The modernization of VA's medical information system is being carried out under the Decentralized Hospital Computer Program. As part of this program, VA has installed new computer hardware and internally developed software in nearly all of its medical centers. While we believe this program shows great promise, in a 1987 report we suggested several important and necessary improvements. These included better controls over the software development process and security procedures for the data centers, improved analysis of the costs and benefits of the new software, and more effective procedures for managing hardware capacity. VA has begun action on these suggestions, but the Secretary should make sure that they are fully implemented.

VA's reliance on the current program to provide automated support to its medical centers is a reasonable approach for now. However, in a few years VA will need to make additional and substantial investments in this system. At that time, alternatives to continuing the current approach could include adapting other systems or developing a new system using an alternative approach. Before making these additional investments, GAO once again urges VA to evaluate the full range of available options.

VA has developed a 12-part, 9-year plan to modernize the information systems supporting its benefit programs. Implementation is to be completed in 1994. Successful implementation of this program should greatly improve the quality of VA's benefit services. To date, VA has completed 3 of the 12 parts of the plan. For the modernization effort to be successful the other 9 parts must be completed effectively.

In addition to this effort, VA has identified 13 interim, short-term projects that address the critical needs of its existing information systems. These interim projects should introduce significant benefits for VA, but they do not address fully all of the critical shortcomings of the existing information systems. VA must sustain its commitment to the timely completion of the 12-part modernization plan, and not consider the interim projects as a substitute.

Related GAO Products

Use of Information Technology by VA's Department of Veterans Benefits (GAO/T-IMTEC-88-6, July 28, 1988).

VA Health Care: Monitoring of Cardiac Surgery and Kidney Transplantation (GAO/HRD-88-70, May 26, 1988).

Establishment of the Veterans Administration As a Cabinet Department (GAO/T-HRD-88-11, Mar. 15, 1988).

VA Health Care: Plans to Ensure Compatibility of Two Medical Management Systems (GAO/HRD-88-45, Dec. 21, 1987).

ADP Systems: Department of Veterans Benefits Modernization Program (GAO/IMTEC-88-3, Oct. 30, 1987).

VA Health Care: Resource Allocation Methodology Should Improve VA's Financial Management (GAO/HRD-87-123BR, Aug. 31, 1987).

Hospital ADP Systems: VA Needs to Better Manage Its Decentralized System Before Expansion (GAO/IMTEC-87-28, July 24, 1987).

VA Health Care: VA's Patient Injury Control Program Not Effective (GAO/HRD-87-49, May 18, 1987).

VA Health Care: Issues and Concerns for VA Nursing Home Programs (GAO/HRD-86-111BR, Aug. 8, 1986).

Financial Management: An Assessment of the Veterans Administration Major Processes (GAO/AFMD-86-7, June 27, 1986).

VA Hospitals: Surgical Residents Need Closer Supervision (GAO/HRD-86-15, Jan. 13, 1986).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

(118832)

United States General Accounting Office

GAO

Transition Series

November 1988

NASA Issues

GAO/OCG-89-15TR

GAO United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Administrator-designate of the National Aeronautics and Space Administration

This transition report is one in a series which address critical program management issues facing the new administration and Congress. The issues, the problems associated with each, and recommended actions are based on the results of our work in the National Aeronautics and Space Administration (NASA). Some of our concerns are new, while others represent unresolved problems over many years.

This report identifies three important issues we believe should be included in whatever agenda Congress and the Administrator of NASA set for the agency. They are (1) providing better information on where NASA is headed and at what cost, (2) minimizing the future cost of the space station, and (3) launching deep space science missions on time.

These issues are discussed in detail in the reports listed at the end of this report. We expect to identify other issues in the near future since we have expanded our work effort at NASA in anticipation of its recovery from the Challenger accident and the Agency's increased efforts on other major programs, such as the space station.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

NASA Must Develop a Strategic Plan and Report Full Project Costs to the Congress 4

NASA Must Institutionalize a Life-Cycle Cost Management Process for the Space Station 7

NASA Must Launch Deep Space Science Missions on Schedule to Avoid Costly Delays 9

Related GAO Products 12

Transition Series 14

NASA Must Develop a Strategic Plan and Report Full Project Costs to the Congress

Congressional and executive branch decisionmakers will soon be making the difficult choices on what civil space projects the nation will undertake. Effective decisions require reliable information on where NASA is headed and what it will cost to get there. However, NASA does not yet have a strategic long-term plan nor does it consistently report the full costs of its projects.

NASA's future funding requirements will triple by the year 2000—to $32 billion or more—if some recently proposed initiatives, such as a lunar outpost or a staffed Mars expedition, are adopted. Even without such significant new initiatives, NASA's future funding requirements could double.

If NASA is to provide the technological leadership necessary to put the United States at the forefront of advancements in aeronautics, space science, and exploration, it must develop a strategic plan which clearly states its vision for the future and the steps to realize that future in an affordable manner. NASA is currently evolving a strategic planning process throughout the Agency and has made a commitment to prepare an overall strategic plan. We support these efforts and urge that NASA set a timetable and follow through on them.

As NASA has recognized in developing its strategic planning process, all Agency planning should be interrelated and consistent. For example, while strategic planning imparts overall direction and purpose to an agency's programs, the nearer term budget process is used to justify and provide the resources needed to implement those programs and their supporting projects.

In support of these linkages, one thing NASA must do is to report the full picture of resources required to develop and operate specific projects. This will help the Congress and the executive branch to set the content and pace of NASA's pursuit of its overall strategic goals and objectives and to make the best possible decisions on what NASA projects the nation can afford to fund. However, NASA does not typically report the full costs of its projects to the Congress.

The space station dramatically illustrates how incomplete NASA's project cost reports can be. In 1987, NASA told the Congress that the space station would cost $14 billion, leaving out an additional $14 billion needed to launch and assemble it in space. Omissions of this type are not unusual. The project cost estimates reported by NASA typically have not included such directly related project costs as launch and assembly, personnel and facilities, and work provided by other U.S. agencies.

NASA has the capability to report more complete project costs and on occasion has done so in project status reports (PSRs) requested by one of its oversight committees. We believe that routine full-cost reporting to the Congress will facilitate decisions on what projects the nation should undertake. We are currently assessing how the PSRs can be adapted to provide more complete project cost estimates to the Congress in a systematic fashion across all significant NASA projects. We will report to NASA's oversight committees in the spring of 1989 on the utility of the PSRs for providing better project cost estimates and on NASA's efforts to expand their use.

NASA Must Institutionalize a Life-Cycle Cost Management Process for the Space Station

The space station will consume a substantial portion of NASA's annual funding for decades to come. Development costs are already estimated at $28 billion, and annual operations costs are currently estimated at $1.4 billion. Both estimates are expected to rise. It is imperative that NASA employ a management system that identifies design proposals which minimize costs over the space station's 30-year life.

Thinking in life-cycle terms can clearly save money in the long term. For example, while NASA does not yet have a life-cycle cost management system, it has studied designs it believes will have major impacts on operations costs. One such study examined water system alternatives for the station and found that a system which recycles water costs $52 million more to develop than a system where water must be discarded and replaced. However, the recycle system costs over $1 billion less to operate over the life of the station. Given comparable performance and schedule results, the best interests of the government would obviously be served by the system which initially costs more to develop, and NASA did elect to develop the recycle system.

There are, however, intense pressures to hold down current government spending, increasing the risk that NASA will select increasing the risk that NASA will select design options with low front-end development costs even though they may require much higher outlays over the life of the project. In such an environment, a life-cycle cost management process is clearly needed.

It is imperative that NASA institutionalize a life-cycle cost management process—and do it now—before space station managers begin making firm design decisions. Without such a process, NASA will be unable to assure itself and the Congress that it has identified the most cost-effective space station design.

NASA has been asked by its House Authorizing Committee to expedite development of the process and to report on its establishment prior to starting the preliminary design review phase of the space station, which is scheduled to begin during April-June 1989. Funding of this phase, and all subsequent space station activities, should be contingent on NASA's satisfactory response to these requirements.

NASA Must Launch Deep Space Science Missions on Schedule to Avoid Costly Delays

Hundreds of millions of dollars and the time and talents of hundreds of scientists and engineers could be wasted if NASA does not launch its deep space science missions on time. NASA cannot afford such extra costs and therefore must fully weigh the consequences of any decision not to launch these missions on schedule.

When a deep space science mission is not launched as scheduled, the mission must wait for the planets to move into another acceptable configuration—this frequently takes years. For example, if NASA fails to launch the Magellan mission to Venus in the spring of 1989, it will be delayed 25 months and cost $100 million more to prepare.

The extra $100 million is based on the $4 million NASA spends every month that a deep space science mission is delayed to (1) re-plan the route to and around the target planet, (2) update and maintain the scientific instruments, (3) reprogram the flight software, and (4) support the scientists and engineers and keep them interested in staying on a project which is not producing any scientific data.

Operations costs can also go up when NASA misses a launch. A mission's complexity and length can be increased when there is a less than optimum configuration of planets and NASA cannot use the fastest, most direct route consistent with the mission's scientific objectives.

For example, Galileo would have reached Jupiter in as little as 2 years if it had not missed a launch date with a fast and direct route. The current launch requires a much longer and slower route, with a total cruise time of 6 years. So far, the increased flight time has added $250 million to Galileo's projected operations costs.

These increased costs to develop and operate deep space science missions provide no comparable increased benefits in the scientific data collected. Thus, it is imperative that decisions to not launch on schedule be made with full recognition of the unique requirements of such missions and the cost versus benefit consequences of the no-launch decision.

Of course, not all causes for future deep space science mission launch delays will be foreseeable or controllable by NASA, such as greater than expected difficulties in developing a mission's scientific instruments. However, when there are controllable situations, such as deciding on competing launch proposals from within and outside NASA, including from DOD,

NASA Must Launch Deep Space Science Missions on Schedule to Avoid Costly Delays

NASA's new top management should not agree to postpone the launch of any deep space science mission which is, or will be, ready to go without fully weighing the consequences. Such action would be consistent with the fact that NASA program officials recently established the protection of all space science missions' schedules, resources, and launch opportunities as their highest priority.

Related GAO Products

Civil Space: A Strategic Planning Process Is Being Developed by NASA (NSIAD-89-30BR, Nov. 1988).

Space Station: National Aeronautics and Space Administration's 1987 Cost Estimate (NSIAD-87-180FS, June 1987).

National Aero-Space Plane: A Technology Development and Demonstration Program to Build the X-30 (NSIAD-88-122, Apr. 1988).

Space Science: Status of the Hubble Space Telescope Program (NSIAD-88-118BR, May 1988).

Space Station: NASA Efforts to Establish a Design-to-Life-Cycle Cost Process (NSIAD-88-147, May 1988).

Space Exploration: NASA's Deep Space Missions Are Experiencing Long Delays (NSIAD-88-128BR, May 1988).

Space Exploration: Cost, Schedule, and Performance of NASA's Magellan Mission to Venus (NSIAD-88-130FS, May 1988).

Space Exploration: Cost, Schedule, and Performance of NASA's Galileo Mission to Jupiter (NSIAD-88-138FS, May 1988).

Space Exploration: Cost, Schedule, and Performance of NASA's Ulysses Mission to the Sun (NSIAD-88-129FS, May 1988).

Space Exploration: Cost, Schedule, and Performance of NASA's Mars Observer Mission (NSIAD-88-137FS, May 1988).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

United States General Accounting Office

GAO

Transition Series

November 1988

Energy Issues

GAO/OCG-89-16TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Secretary-designate of Energy

This report is one of a series that summarizes major policy, management, and program issues facing agency heads in the new administration. Through our work in these areas, we have identified many concerns—some relatively new, others long-standing. In a number of cases, we have recommended actions to the Secretary and to the Congress to deal with unresolved problems.

This report on the Department of Energy describes our concerns about the following issues: (1) modernizing and managing the safe operation of the Department's nuclear weapons complex, (2) reducing the nation's vulnerability to oil disruptions, (3) developing a nuclear waste program, (4) commercializing clean coal technologies, (5) responding to changes in the electric utility industry, (6) improving controls over the export of sensitive nuclear data, and (7) revitalizing the uranium enrichment program.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Modernizing and Safely Operating the Nation's Nuclear Weapons Complex 4

Reducing U.S. Vulnerability to Oil Disruptions 8

Developing a Credible Program for Nuclear Waste Disposal 13

Commercializing Clean Coal Technologies 19

Responding to the Changing Infrastructure of Electric Utilities 23

Improving Control Over Nuclear Weapons Information, Technology, and Exports 27

Revitalizing the Nation's Uranium Enrichment Program 32

Related GAO Products 35

Transition Series 37

Modernizing and Safely Operating the Nation's Nuclear Weapons Complex

Much of the Department of Energy's (DOE) nuclear weapons facilities have deteriorated and present serious operational, safety, and environmental problems. Dealing with these problems poses formidable but essential tasks, including (1) upgrading existing facilities, (2) decontaminating obsolete facilities, (3) disposing of stored radioactive waste, and (4) cleaning up environmental contamination. While data are preliminary, the costs of dealing with these problems will be over $100 billion and possibly much higher.

For several years, we have voiced serious concerns about the effectiveness of DOE's management and safety oversight of the weapons complex. Inadequate attention to safety and environmental concerns over the years has created serious credibility problems for DOE. DOE needs to emphasize to line managers their responsibility and accountability for dealing with safety and environmental problems while also strengthening its internal capability for ensuring the problems are being identified and resolved.

The Nuclear Weapons Complex Has Deteriorated

DOE must develop a strategy for prioritizing and addressing problems at the nuclear weapons complex.

In March 1987, we called for DOE to develop a strategic approach for prioritizing and addressing problems at the nuclear weapons complex. DOE has promised to develop a strategy by December 1988 that will include the costs and time frames for modernization. DOE must ensure that this strategy is comprehensive and does not become an academic exercise. It should be a "road map" for the future—an evolving document that changes as DOE's information about the complex is fine-tuned, so that the Congress and the administration can make informed decisions and establish priorities on the most complete, up-to-date information.

The cost of addressing the problems at DOE's defense complex is staggering. While data are preliminary, we estimate the cost will be from about $100 billion to over $130 billion. Modernization plans under consideration, including expanded plant capabilities and relocation of some facilities, could add another $15 billion to $25 billion. These cost estimates are not firm and are likely to increase. The administration must weigh these costs against competing priorities in a deficit-conscious environment. The December 1988 strategy statement should include preliminary information regarding the timing of these expenditures.

DOE Lacks Adequate Oversight

Oversight roles and functions regarding both DOE's internal and newly established independent, external review of operations need strengthening.

In concert with developing its modernization strategy, DOE needs to strengthen its internal program to oversee the complex. For example, specifically budgeting and accounting for funds dedicated to waste management and cleanup will provide clear information to the Congress concerning how DOE is funding activities to comply with important environmental laws. DOE should also establish meaningful safety standards and implementation policies to ensure continued safe operation of existing facilities and to use as baseline safety criteria for developing the strategy for the complex. In addition, the Congress should legislatively establish the position of Assistant Secretary for Environment, Safety, and Health to ensure that these important issues have the statutory base that ensures internal visibility and attention by top DOE management, especially when compared with nuclear materials production.

The Congress recently established an external group to independently oversee the health and safety activities of DOE's nuclear facilities. However, some production and waste storage facilities are exempt from this oversight. Given the sensitivity of public concerns about nuclear power and DOE's track record, such oversight may need strengthening to provide a higher assurance that DOE's current facilities are operated, and new facilities are designed, in a safe and environmentally acceptable manner.

Reducing U.S. Vulnerability to Oil Disruptions

Lower oil prices since 1986 have triggered three potentially negative trends—increasing oil consumption in the transportation sector; rising oil imports, particularly from the Organization of Petroleum Exporting Countries (OPEC); and a further decline in U.S. oil production. A continuation of these trends, together with an anticipated reduction in worldwide non-OPEC oil supplies at some point during the next decade, may increase U.S. dependence on oil from OPEC producers in the Middle East.

Although the United States is currently well-positioned to cope with an oil supply disruption—principally through the continued development of the Strategic Petroleum Reserve (SPR)—its ability to respond to future disruptions could prove inadequate. Policymakers can help reduce both overall dependence on oil and vulnerability to future disruptions by focusing actions in four areas.

The Transportation Sector

Policies should encourage alternative fuels and emphasize more efficient fuel use.

Transportation accounts for two-thirds of all oil used in this country. Not only is this sector 97-percent dependent on oil, it is the only sector of the economy in which oil consumption has continued to increase over the last decade. Thus, policymakers would be wise to develop alternative fuels and improve energy efficiency in this sector. Four policy instruments available to the government for this purpose are (1) fuel efficiency standards, (2) gasoline taxes, (3) research and development programs for alternative fuels and vehicle prototypes, and (4) regulations governing fuel and/or vehicle use.

There have been two recent governmental actions in this area with potentially different effects on oil use in the transportation sector. Legislation has recently been approved that provides incentives for the manufacturing of vehicles using alternative fuels, e.g., methanol and ethanol. These incentives would provide credits towards meeting automobile efficiency standards for vehicles capable of using alternative fuels and would fund a government demonstration program of alternative fueled vehicles. On the other hand, the Department of Transportation has recently announced the relaxation of the automobile efficiency standards for the 1989 model year from 27.5 to 26.5 miles per gallon.

The Strategic Petroleum Reserve

Policymakers should continue to build strategic stocks and resolve early response disputes in the International Energy Agency.

U.S. policymakers should continue to improve energy security by supporting the development of the SPR and encouraging similar measures in other major industrial countries. Oil stockpiling, however, is not the only measure that can potentially mitigate the effects of a severe disruption. While some International Energy Agency (IEA) members intend to use their oil stockpiles, others have said they intend to rely initially on measures designed to reduce oil demand during a crisis. Many observers contend that some IEA countries will receive a "free ride" if the United States releases its stocks and other members delay the release of their own stocks in favor of using demand restraints. U.S. policymakers need to reach agreement with other IEA members on the appropriateness and timing of these various response measures.

Other Emergency Response Measures

Policies should include standby measures to avoid overreliance on the SPR during a disruption.

Programs to supplement the SPR, such as driving restrictions or low-income energy assistance, may help mitigate the effects of a disruption. If the SPR does not operate as planned, such measures, if tested and readied for implementation, would be available to help fill the void until problems are resolved. In a related issue, federal-state coordination in energy emergency planning should be an integral component of this nation's energy policy. By maintaining open lines of communication and exchanging information on decisions before, during, and after an emergency, the federal and state governments can better manage the harmful effects of a disruption.

The Economic and Regulatory Atmosphere

DOE and others must work to maintain a stable economic and regulatory atmosphere that encourages investments in oil and alternative energy sources.

Rapid price movements are widely perceived as disruptive to the interests of oil producers and consumers alike. Conversely, gradual and predictable price movement provides time for efficient planning by all affected groups. Recent discussions and studies have sought ways to protect against disruptive price swings without excessive government intrusion. Among various proposed measures are a price floor on imported oil to protect domestic energy projects from rapid, and perhaps politically motivated, price reductions and the use of the SPR to avert rapid price increases even in situations where a full-blown disruption is not imminent. Discussions of the merits and shortcomings of these proposals by the government and industry may lead to increased stability and improve the environment for U.S. energy interests.

Further, a small number of countries may control a significant portion of U.S. energy supplies well into the next century. Access to these sources must remain among the highest priority foreign policy goals of our government. DOE must work closely with the State Department to assure that State is fully informed on issues of energy supply and thus able to pursue U.S. interests effectively in its contacts with foreign governments and international organizations.

Developing a Credible Program for Nuclear Waste Disposal

Thousands of tons of highly radioactive waste continue to accumulate at over 100 commercial reactors and at DOE facilities. The Nuclear Waste Policy Act of 1982 provided for the permanent disposal of these wastes in underground repositories to be financed by fees collected from utilities and DOE.

The Congress revised the act in December 1987, however, in response to continuing opposition to DOE's efforts to identify sites for two repositories and estimates of program costs that had increased from $23 billion to over $30 billion (in constant 1987 dollars). The Congress directed DOE to investigate only one candidate repository site—Yucca Mountain, Nevada—but limited the amount of waste that can be disposed of in the repository until a second one is ready to operate. DOE is required to report on the need for a second repository between 2007 and 2010. The Congress also authorized DOE to develop a facility to receive, package, and temporarily store waste prior to its disposal in the repository but conditioned development of the facility on progress in developing the repository.

The estimated cost to develop and operate these facilities and potentially a second repository, coupled with much lower current projections of waste that will be generated by commercial reactors, raise questions about the amount of disposal capacity required, the timing of facility development, and the adequacy of current disposal fees.

In addition, technical and environmental concerns at the Waste Isolation Pilot Plant, authorized by the Congress to store transuranic waste, raise serious questions that must be addressed before DOE can demonstrate that the facility is suitable as a repository for permanent disposal of this type of waste.

Establish Capacity of Yucca Mountain Now

Earlier and more complete evaluation of the disposal capacity of Yucca Mountain could avoid the need for additional, more expensive investigation in the event of a future decision to expand the repository.

DOE intends to investigate the suitability of Yucca Mountain for a repository between 1989 and 1994. If the investigation results are positive and the site is selected, DOE will seek approval from the Nuclear Regulatory Commission to build a repository capable of holding up to 70,000 metric tons of waste. If, in about 20 years, the quantity of waste is expected to exceed that amount, then DOE will recommend either that the Yucca Mountain repository be enlarged or that a second repository be developed.

We have found that

- the total amount of waste expected to be produced over their useful lives by existing nuclear power plants and government defense programs, originally estimated at about 160,000 metric tons, is currently estimated at only 96,000 to 105,000 metric tons;
- DOE is uncertain if the Yucca Mountain site can accommodate this amount; and
- adding a second repository would increase the cost of the waste program by about $8 billion.

Reassess Storage Facility Benefits

DOE needs to identify, with supporting analyses, the benefits and costs of a facility for monitored retrievable storage of wastes when development of the facility is tied to progress in developing a repository.

In March 1987 DOE proposed developing a facility in Tennessee to receive, process, and temporarily store wastes before shipping them to a repository for disposal. DOE estimated that the facility would add about $1.5 billion to waste program costs. Among other reasons, DOE wanted to build the facility to meet its contractual obligation to begin accepting waste in 1998 instead of 2003 when it expected to open a repository.

The Congress authorized the facility but, to ensure that the facility will not detract from repository development, prohibited DOE from constructing it until the Nuclear Regulatory Commission has authorized construction of a repository. This and similar conditions will prevent DOE from implementing its waste system early as it had anticipated. For example, the existing conditions would not permit DOE to use the facility to achieve its objectives of

- planning and implementing key waste system elements, such as transportation routing requirements, 5 to 8 years before opening the repository;
- eliminating the need for 10,000 metric tons of new waste storage capacity at nuclear plants, thereby saving utilities up to $1 billion; and
- gaining experience in interacting with state and local governments that would aid in repository development.

Eliminating these perceived benefits raises questions about whether the facility is now worth its additional cost to the waste program. The Congress has established a Monitored Retrievable Storage Review Commission to study the need for the facility and report its findings to the Congress on June 1, 1989. The Commission needs the benefit of DOE's reevaluation of the facility to ensure that it has the best information for its report.

Address Uncertainties of Waste Isolation Pilot Plant

DOE needs to address many uncertainties with the plant before the facility is used as a repository for transuranic waste.

In December 1979, the Congress authorized DOE to build and operate a facility for the safe disposal of transuranic waste (material that is contaminated with man-made radioactive elements). The facility is essentially constructed, and DOE soon plans to store waste in it; however, we recently testified that a technical issue—the amount of brine seepage that might occur—and environmental concerns might prevent the facility from meeting the Environmental Protection Agency's standards for nuclear waste repositories.

DOE must be prepared to answer several questions about the consequences of the facility being judged unsuitable after a planned demonstration phase is complete, including (1) the feasibility of retrieving waste from the facility, (2) costs of retrieval, and (3) decisions about where the retrieved wastes would be stored.

Commercializing Clean Coal Technologies

To develop additional electrical generating capacity for expected demand increases, utilities will need to decide whether to build new plants or upgrade existing ones. Because emissions from coal-fired plants contribute to acid rain, utilities' decisions will be largely influenced by the technological options available and acid rain control requirements the Congress may enact. DOE and the Congress need to foster development of cost-effective ways to burn coal more cleanly, both to control acid rain and to improve our energy security by reducing dependence on imported oil and gas.

Clean Coal Program Should Focus on Promising Technologies

DOE should focus the Clean Coal Technology Program on the more promising technologies that utilities will be likely to adopt.

DOE's Clean Coal Technology Program, a 5-year, $5-billion, cost-shared demonstration program, is designed to encourage the commercialization of emerging clean coal technologies by providing federal funding of up to 50 percent, or about $2.5 billion, of project costs. Utilities may not adopt emerging clean coal technologies unless they have been proven technically reliable, cost-effective, and environmentally acceptable.

The Electric Power Research Institute has estimated that for similar technologies to those being demonstrated under the Clean Coal Technology Program, the commercial availability dates range from 1992 to 2000, with most potentially available in the mid-1990s. According to the Institute, some technologies are further along the process of commercialization than others but are not "on the market," in the sense of being mature technologies with numerous units installed or ordered for commercial operation, and with well-defined cost, performance, and risk profiles. The Institute pointed out that clean coal technologies need to be replicated in several demonstration projects to encourage their commercialization. Therefore, in addition to funding the development of emerging clean coal technologies, DOE should also support multiple demonstrations of the most promising technologies that utilities would be likely to adopt.

Controlling Acid Rain Should Be Linked to Clean Coal Technologies

Acid rain control legislation should be linked with the Clean Coal Technology Program.

About 20 bills to control acid rain have been introduced in the Congress since January 1987. Most would amend the Clean Air Act by requiring reductions in sulfur dioxide and nitrogen oxide emissions associated with fossil fuel combustion. The bills contain varying compliance dates, target levels for emissions reductions, or other provisions to control emissions that cause acid rain.

The enactment of acid rain control legislation could affect the future use of emerging clean coal technologies. If legislative compliance deadlines take effect before funded technologies are commercially available, or if target levels to reduce emissions are higher than the technologies can attain, utilities would be likely to comply with the new requirements by switching to low-sulfur coal, cleaning coal before combustion, or using scrubbers to remove sulfur dioxide from coal combustion gases. However, coal switching could disrupt the high-sulfur coal mining industry; current coal- cleaning methods have not been highly effective in reducing emissions; and utilities investing heavily in scrubbers on existing plants are not likely to expend additional resources to acquire newly developed clean coal technologies for those same plants. Consequently, the Clean Coal Technology Program's potential benefits could be unrealized for a large portion of the power plants that now use coal-fired boilers.

While the Congress is debating legislative proposals for controlling acid rain, DOE should propose an approach to the Congress that links compliance dates for emissions reductions with the expected commercial availability of emerging clean coal technologies.

Responding to the Changing Infrastructure of Electric Utilities

In the 1970s electric utilities' previously stable environment dramatically changed following disruptions in the world oil markets and the accident at the Three Mile Island nuclear power plant. By the mid-1980s the electric utility industry was characterized by (1) geographic areas with surplus electric generating capacity, (2) little construction of new power plants, (3) a need for additional generating supplies in some regions to meet electricity demand in the mid-1990s, and (4) financial difficulties for some utilities. As the 1990s approach, the infrastructure of the electric utility industry is changing in response to uncertainties in its operating environment.

Non-Utility Sources of Electricity Supply Are Increasing and Utility Corporate Structures Are Changing

DOE should monitor the current trends in (1) non-utility development of electricity generating sources, with particular emphasis on whether this trend will lead to an adequate and reliable supply of electricity and (2) the utility industry's changing corporate infrastructure.

Rather than initiate new power plant construction, a growing number of utilities are seeking to purchase power from other utilities or from non-utilities that are becoming the new suppliers of electricity. The trend for utilities to purchase power rather than to construct generating facilities appears to stem from the perception of high financial risks and unfavorable state regulatory treatment of construction costs for power plants.

Additionally, corporate restructuring is occurring in an apparent effort to improve utilities' financial situations. Some utilities are merging, while others are selling and then leasing back generating facilities. In other instances, utilities are diversifying by forming subsidiaries in utility- and non-utility-related business. Another change is increased formation of utility holding companies.

Utilities' reluctance to undertake major construction of power plants and individual utility corporate restructuring efforts have led to concerns by some Members of Congress and others within the industry. Major questions are whether non-utility development of generation sources will result in an adequate and reliable supply of electricity to meet future needs, and what effect corporate restructuring efforts will have on the industry. A clearer understanding of the nature of the changing utility industry would appear to be a first step in resolving these concerns.

Federal Regulatory Purview Over Electric Utility Activities Is Expanding

DOE should monitor the changing nature of utility regulation and the Federal Energy Regulatory Commission's proposed rulemakings to ensure that issues besides electricity rates are addressed.

Regulation of electricity rates is shifting from the states to the federal government. The number of wholesale electric power transactions, which are regulated by the Federal Energy Regulatory Commission (FERC), is increasing as utilities seek to purchase supplies rather than construct generating facilities. At the same time, federal regulatory proposals signal a trend toward increasing competition among potential power suppliers as a means of establishing electricity rates. Three recent FERC proposed rulemakings are intended to clarify the pricing of power from nonutility sources (cogenerators and small power producers), to promote competitive all-source bidding for new supplies of generation, and to relax the regulation of nonutility power producers.

A concern of many within the electric utility industry related to the FERC proposals is the failure of FERC to address the key issue of transmission access and its interrelationship to the proposals. While FERC has indicated its plans to address transmission access in upcoming proposals, industry representatives believe the current proposals, as well as transmission access issues, need to be addressed concurrently. A more comprehensive overview of the changing federal regulatory purview over electric utilities and its consequences appears warranted.

Improving Control Over Nuclear Weapons Information, Technology, and Exports

The proliferation of nuclear weapons remains a global concern. It is widely believed that countries are pursuing—or may have achieved—the capability to produce the necessary plutonium or enriched uranium and to develop the technology and components needed for nuclear weapons. Reports of Israel's nuclear arsenal, Pakistan's nuclear weapons capability, and the possibility that these and other nations try to obtain nuclear weapons information and technology from the United States, have heightened proliferation concerns.

Controls Do Not Protect Unclassified Weapons Information

DOE must have effective controls over information that it develops on nuclear weapons and exports of nuclear material and technology for peaceful purposes.

Since 1974, when India exploded a nuclear device, the United States has tried to limit weapons proliferation by strengthening its controls over information, technology, and equipment that could assist those nations believed to be developing nuclear weapons. The major control mechanism—classification of weapons information and technology—protects only the most sensitive weapons data. However, other nuclear-related technology and components have commercial applications (dual-use) and are readily available. Under the Atomic Energy Act, as amended by the

Nuclear Nonproliferation Act, several agencies, including DOE, oversee and approve the export of U.S. nuclear-related technology and information. In addition, the act provides DOE authority to limit the dissemination of information related to nuclear weapons development and production.

Nevertheless, countries known to be interested in developing weapons routinely obtain unclassified data published by DOE and other commercially available technology that relates to the production of special nuclear material or the development of weapons components. In addition, each year DOE allows into its weapons laboratories thousands of foreign visitors from communist countries and nations deemed sensitive because of proliferation concerns. DOE studies have concluded that unclassified information may provide foreign countries details on sensitive—and even classified—activities that the United States conducts. These situations pose serious threats to U.S. security because they may enable countries to develop and/or improve their nuclear weapons capabilities. As a result, concerns have been raised in the Congress and by nonproliferation experts about the continued dissemination of nuclear information and the export of nuclear-related equipment and technology.

DOE has a number of options to better control information and technology that could be useful to proliferation-risk nations. DOE should strengthen its internal procedures for reviewing unclassified but sensitive scientific and technical information before it is released. DOE should also improve its coordination with other cognizant agencies by providing updated information on the "state-of-the-art" and emerging technologies that warrant greater scrutiny and attention before export licenses are approved. In addition, to prevent security breaches, DOE must improve its controls over foreign visits to the weapons laboratories by strengthening its screening criteria and oversight.

DOE Is Faced With Conflicting Legislation

DOE must balance the dual objectives of controlling, yet disseminating, nuclear information and technology.

The Atomic Energy Act requires DOE to control sensitive information and technology, but the Stevenson-Wydler Act and the Technology Transfer Act promote commercialization of unclassified technology by making all government information (unless classified) available to any person who requests it. Because of the scientific nature of its facilities, some groups in DOE seek to publish as much data as possible in order to facilitate scientific understanding and allow widespread dissemination of technological advances. However, other groups in DOE believe that information dissemination needs to be restricted because some of the data published has nuclear weapons applications as well as peaceful uses. Therefore, by taking the actions specified below, DOE could ensure that technology and information are made available to domestic users but not to countries seeking to develop or improve nuclear weapons.

Actions that we believe DOE could take to meet the sometimes conflicting legislative requirements for disseminating technical data include the following:

- Proposing amendments to the Atomic Energy Act to broaden the types of information that can be protected under the regulations for Unclassified Controlled Nuclear Information.

- Developing approaches to exempt all sensitive technology from disclosure under the Freedom of Information Act. DOE could seek an exemption, similar to the Department of Defense's, for controlling unclassified information related to all aspects of nuclear weapons and nuclear material production.

- Placing additional data in the applied technology category and making them subject to special distribution controls. DOE limits the distribution of applied technology information to domestic recipients, thereby retaining the foreign trade value of the data.

Revitalizing the Nation's Uranium Enrichment Program

DOE's uranium enrichment program faces an uncertain future because of increased foreign competition, mandatory payments for unneeded electricity, and billions of dollars in unrecovered costs. The program's production facilities, built in the 1940s and 1950s, face uncertain decommissioning and environmental cleanup costs.

Conflicting Program Objectives

DOE and the Congress must resolve the program's competing objectives and place the program on sound financial footing.

In 1969, when DOE began producing enriched uranium for commercial customers, it was the world's sole supplier, and the demand for nuclear power was expected to grow rapidly. As a result, in the 1970s DOE decided to build a new plant and signed long-term contracts for large amounts of electricity needed to enrich uranium. Later, electricity demand fell, foreign competition grew, and the program's previously incurred costs, which are to be recovered through program revenues, soared. In 1986, DOE wrote off about $4.1 billion in unrecovered costs for improvements in existing facilities and for the partially completed new plant because it was not needed to produce enriched uranium. However, DOE did not have legislative authority to take the write-off. By

1988, according to our calculations, these unrecovered costs totaled about $9 billion, including the write-off.

If DOE is to recoup an estimated $9 billion for all past unrecovered costs, including almost $1 billion a year in imputed interest, then it cannot market enriched uranium at prices that are competitive with those of foreign suppliers. Conversely, if DOE is to remain a reliable supplier for domestic nuclear utilities, DOE must make adjustments regarding program cost recovery.

Legislative proposals over the last 2 years would (1) restructure the program as a government corporation, (2) write off almost all past unrecovered costs, (3) require the program to pay for part of the cost of cleaning up uranium mill tailing sites, and/or (4) require the purchase of thousands of tons of unneeded uranium ore from domestic miners. The Senate passed uranium enrichment legislation; the House did not because of opposition to the cost write-off provisions.

To place the enrichment program on firm financial footing, DOE and the Congress must

- determine a reasonable cost recovery amount, which should be consistent with the $3 billion to $3.5 billion that DOE estimates it can reasonably expect to generate from its production facilities over the next 10 years;

- provide the program with budget and management flexibility, perhaps by establishing a government corporation under the Government Corporation Control Act;

- allow flexible pricing strategies; and

- require the recovery of decommissioning costs.

Finally, DOE and the Congress must consider the extent to which the enrichment program should be responsible for the domestic mining industry. Under proposals introduced by the 100th Congress, DOE would be required to purchase domestically produced uranium that it does not need. Because this uranium would likely come from existing inventories, the extent to which such purchases would help domestic miners is questionable.

Related GAO Products

Nuclear Weapons Complex	Nuclear Health and Safety: Dealing With Problems in the Nuclear Defense Complex Expected to Cost Over $100 Billion (GAO/RCED-88-197BR, July 6, 1988). Key Elements of Effective Independent Oversight of DOE's Nuclear Facilities (GAO/T-RCED-87-32, June 16, 1987). Environmental, Safety and Health Aspects of the DOE's Nuclear Defense Complex (GAO/T-RCED-87-4, Mar. 12, 1987).
Energy Security	Energy Security: An Overview of Changes in the World Oil Market (GAO/RCED-88-170, Aug. 31, 1988). Oil Reserves: An Analysis of Oil Fill Alternatives (GAO/RCED-87-145BR, May 21, 1987).
Nuclear Waste	Fourth Annual Report on DOE's Nuclear Waste Program (GAO/RCED-88-131, Sep. 28, 1988). GAO's Views on Monitored Retrievable Storage of Nuclear Waste (GAO/T-RCED-88-55, July 26, 1988).
Clean Coal Program	Views on DOE's Clean Coal Technology Program (GAO/T-RCED-88-47, June 22, 1988).

Electricity	Canadian Power Imports: A Growing Source of U.S. Supply (GAO/RCED-86-119, Apr. 30, 1986).
Nonproliferation	Nuclear Nonproliferation: Major Weaknesses in Foreign Visitor Controls at Weapons Laboratories (GAO/RCED-88-31, Oct. 11, 1988).
	Nuclear Nonproliferation: Department of Energy Needs Tighter Controls Over Reprocessing Information (GAO/RCED-87-150, Aug. 17, 1987).
	Nuclear Nonproliferation: DOE Has Insufficient Control Over Nuclear Technology Exports (GAO/RCED-86-144, May 1, 1986).
Uranium Enrichment	Uranium Enrichment: Congressional Action Needed to Revitalize the Program (GAO/RCED-88-18, Oct. 19, 1987).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

United States General Accounting Office

GAO

Transition Series

November 1988

Treasury Issues

GAO/OCG-89-17TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Secretary-designate of the Treasury

This report is one of a series outlining critical issues confronting Congress and the new Administration. As a leader in formulating economic policy, improving financial management, and regulating financial institutions, the new Secretary must help address many daunting challenges. These include (1) restoring stability to a shaken financial services industry; (2) developing policies to address the pressing U.S. trade deficit; and (3) enhancing reform efforts to improve the government's second-rate accounting systems. These challenges are discussed in detail in separate transition reports issued by GAO and listed in the back of this summary.

The new Secretary also must address serious problems within Treasury. Significant internal control weaknesses are undermining the Department's effectiveness in controlling trillions of dollars. There is a critical need to monitor the progress of major new information systems such as IRS' total redesign of the tax processing system.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Restoring Stability to a Troubled Financial Services Industry 4

Formulating Economic Policies to Address the Trade Deficit 8

Ensuring Financial Management Reform 9

Managing Treasury's Critical Information Technology Challenges 10

Addressing Treasury's Serious Internal Control Problems 14

Working With the New Inspector General 18

Related GAO Products 19

Transition Series 20

Restoring Stability to a Troubled Financial Services Industry

As detailed in our transition report entitled Financial Services Industry Issues, (GAO/OCG-89-4TR), our nation's financial institutions and markets are in a period of dynamic change. The new Secretary of the Treasury, working in conjunction with other key members of the Administration, will be confronted with an array of critical issues. These include deciding how to:

- finance the billions of dollars that will be needed to restore financial stability to insolvent institutions;
- allow banks and other financial businesses to merge while still protecting the unique and vital functions they perform for the public with effective regulation;
- interject regulatory controls to enable financial markets to better cope with any repetition of the October 1987 stock market crash; and
- assure effective regulation of international financial markets.

A summary of our suggested actions follows.

Dealing With Insolvent Institutions

The Secretary should actively support a regulatory strategy aimed at closing insolvent institutions as quickly as possible.

The thrift industry's self-insured system is too weak to solve the problem alone. The solution must be funded by all who have a stake in the industry. The sharing of costs should be based on the principles that 1) funds contributed by the thrift industry should not significantly weaken healthy institutions, 2) funds raised from other depositories should not adversely affect their competitive position, and 3) funds provided by the public should be accompanied by controls to protect the public interest.

Regulating the Banking Industry

Without fundamental changes to the way the thrift industry is regulated, there is little to prevent a recurrence of today's problems. New controls are needed to strengthen the capital base of the industry, improve oversight and supervision to manage risk-taking and limit losses, and provide incentives for insured institutions to control their own risk-taking. Additionally, the schizophrenic position of the Federal Home Loan Bank Board as both an industry advocate and safety and soundness regulator must be eliminated.

The deregulation of banks also must be thoughtfully managed. Limits on banks' powers are being progressively relaxed outside of the existing statutory framework, yielding a hodgepodge of banking and other functions that could threaten the soundness of the banking system.

This uneven expansion of powers is potentially destabilizing, and new ground rules must be legislated quickly. First, regulatory restraints must be relaxed in stages keyed to the pace at which regulatory agencies are staffed and otherwise equipped to assure adequate oversight. Second, the holding company structure should be required for any institution that proposes engaging in both banking and nonbanking lines of business. Third, new legislation should impose and firmly enforce rigorous standards for the adequacy of capital at both the bank holding company and bank levels. Fourth, banks should be permitted to extend credit to securities affiliates only under controlled circumstances, such as providing liquidity in a market emergency. And finally, new legislation should expand the regulatory role of the Federal Reserve to assure effective oversight of integrated financial services firms.

Coping With a Volatile Market

The unpredictability of financial markets, the extent to which separate markets are now intertwined, and the resulting dangers for the national economy were underscored by the October 1987 crash. The new

Administration must decide how to regulate the linked markets and better prepare for a future crisis. Some changes which should be implemented immediately include 1) improving contingency planning between different regulators, 2) improving coordination of the rules and regulations that would be critical in an emergency, and 3) retaining the Financial Market Working Group as a mechanism to assure continued attention to the problems that emerged in the crash.

Operating in an Increasingly International Arena

U.S. financial markets are linked not only with each other, but also with markets in other nations. The new Administration must insure harmonized U.S. and foreign regulatory approaches and a coordinated international response to financial crises.

Initially, we must get our own regulatory house in order by resolving the future structure of the U.S. financial services industry (i.e. the banking powers issues), and the regulatory issues already noted concerning the securities markets. We should simultaneously, in our leadership role, develop means for ensuring prompt exchange of critical information and developing reliable procedures for international coordination in time of emergency.

Formulating Economic Policies to Address the Trade Deficit

The magnitude and duration of the U.S. trade deficit and the transformation of the United States from a creditor to a debtor nation have generated concern that the U.S. economy is in long-term decline.

The trade deficit and the fact that the United States is a debtor nation are both principally attributable to U.S. macroeconomic policy decisions and how these policies differed from decisions made elsewhere. These issues are discussed in our transition report entitled International Trade Issues, (GAO/OCG-89-5TR).

As a principal advisor to the new Administration on economic policy issues, the new Secretary will help formulate policy measures to address the trade deficit. The new Secretary should support measures that will gradually reduce the U.S. budget deficit through the application of fiscal and monetary policies which recognize the interdependent nature of the world's economies.

Ensuring Financial Management Reform

Although the government has an annual cash flow of about $1 trillion dollars, it continues to rely on second-rate financial management systems. Many are antiquated and in disrepair. They produce information that is incomplete, untimely, and unreliable. Nevertheless, important deficit reduction decisions are based on the data produced by these systems.

We have long urged the need for broad-based reform. A full discussion of the governmentwide financial reform issue is provided in our transition report entitled Financial Management Issues, (GAO/OCG-89-7TR). As a key leader in the financial management area, the Secretary should play a central role in this reform effort to: conduct better long-range financial systems planning; maintain strong internal control systems; and produce timely, complete, and reliable financial data.

Managing Treasury's Critical Information Technology Challenges

Treasury relies heavily on automated information systems to carry out many of its critical responsibilities, including tax administration, debt management, and governmentwide accounting operations. Treasury's 1988 commitment to the information technology area is substantial, involving over a billion dollars in obligations and over 8,700 workyears. Treasury's overall expenditures in this area will grow 21% from 1986 to 1988, giving it the second highest growth rate for all Cabinet Departments.

Within the next few years, major new systems or enhancements to existing systems are planned for all of Treasury's major bureaus. In addition, enhancements are planned for major Departmentwide systems including payroll, personnel, and telecommunications. Two Treasury systems, IRS' Tax System Redesign and the Treasury's Financial Management Services (FMS) System 90, were designated as Presidential Priority Systems by the Office of Management and Budget. They represent long-term initiatives that affect substantial portions of the public and/or a major infrastructure in the federal government.

The new Secretary must effectively oversee the redesign of IRS' tax administration system. The new system will have to handle billions of dollars worth of revenues annually and deal with sensitive financial data provided by millions of taxpayers. The redesign costs will likely run into the billions before the entire concept is operational. IRS' current system is woefully out-of-date and not expected to meet growing workload demands much longer.

Treasury and IRS have struggled with this initiative for years. The first three approaches did not proceed beyond the conceptual phase, partly because leadership changes within IRS and Treasury hampered redesign attempts. Full implementation of the target design has slipped from 1995 to 1998. As a result, IRS will have to contend with the problems in its current system for several years longer than expected.

IRS has now developed a basic plan for the redesign which calls for incremental improvements over time. While Treasury officials approved the overall direction set forth in this plan, many critical milestones and actions lay ahead that will require aggressive monitoring. In particular, the development of a defensible set of cost/benefit analyses will be critical as will justifying the system design and implementation before Congress.

A second key challenge for the new Secretary will be to effectively monitor Treasury's Financial Management Service's (FMS) System 90, which will upgrade the FMS computer systems and expand FMS involvement in governmentwide financial management. FMS currently processes 750 million payments annually totaling $900 billion. Groups relying on FMS for payments include 39 million Social Security beneficiaries, 90 million households receiving tax refund payments, 4.4 million veterans or their dependents, and 4.2 million people receiving Supplemental Security Income payments. OMB estimates that FMS' current system loses $50 million annually due to theft and takes 45 days to process benefit payments.

System 90 is a key element in FMS's goal to integrate the various components of the government's $2 trillion in annual financial activities into a secure processing and reporting network. However, the new system is still in the design stage. Given its importance, it is imperative that the Department aggressively monitor its implementation to ensure that the goals of more timely and accurate payments and improved credit management by FMS are achieved.

The new Secretary should

- Recruit high quality managers experienced in information system design and implementation for all critical senior management positions involving information systems within the Department and Bureaus.

- Ensure that all major Treasury information systems are tied into clearly articulated long-range strategic program plans.

- Monitor the redesign of the tax administration system, focusing initially on (a) the development of cost/benefit analyses to use in assessing the total effort; and (b) the establishment of clear management accountability for the project.

- Evaluate the Financial Management Service's System 90 upgrade to insure that the intended objectives of faster and more accurate payment processing and better monitoring of government credit practices are achieved.

Addressing Treasury's Serious Internal Control Problems

In fiscal year 1987, Treasury's accounting systems were responsible for keeping track of

- Over $2 trillion of U.S. public debt activity;
- Over $885 billion collected in taxes; and
- Government payments totaling $900 billion.

Given these enormous responsibilities, the new Secretary must make a strong, ongoing commitment to maintaining financial systems that have strong internal controls. Treasury has made progress in addressing major weaknesses, but major challenges remain. In 1987, Treasury's Bureaus reported 75 material internal control weaknesses, of which 37 were in the financial management area and another 15 were in the automated data processing area. Other weaknesses extended into such important areas as personnel management, cash management, and procurement.

For example, we recently reported on major financial management and internal control problems facing two important Treasury Bureaus—IRS and Customs. At IRS, our October 1988 management review found serious and long-standing problems in the financial management area. IRS' accounting systems are outdated, incompatible, and labor intensive. Significant internal control weaknesses exist in key systems that annually handle billions of dollars. Accurate and timely financial information is not available to key IRS managers. In response to the report, IRS has agreed to a long-term plan of action to address these serious issues. Treasury oversight is essential.

Over the past 3 years, we also have reported on major internal control problems facing the Customs Service's efforts to effectively identify, seize, and dispose of millions of dollars worth of assets from drug traffickers and organized crime figures. These included a "substandard" accounting system for seized property, no national inventory of millions in seized cash, and a lack of clear management accountability throughout the program. Delays in depositing seized cash cost the government millions of dollars in lost interest. While many of these problems are being addressed, Customs still needs to bring its Forfeiture Fund accounting into conformance with GAO standards as required by the Federal Managers' Financial Integrity Act.

Maintaining strong internal controls throughout Treasury will continue to be an ongoing process. Constant changes in systems, people, and procedures require a strong, continual commitment on the part of the Secretary to ensure that Treasury's vital financial systems experience no significant disruptions. To carry out these important responsibilities, the new Secretary should:

- Monitor the timely correction of all material accounting system weaknesses reported by Treasury's Federal Managers' Financial Integrity Act process and require that its process be rigorously applied in the future.

- Recruit high quality financial managers, experienced in financial system design and implementation, for all critical senior level financial management positions within the Department and Bureaus.

- Support IRS' efforts to strengthen and modernize its financial management systems by monitoring IRS' implementation of the GAO management review recommendations.

- Ensure that the Customs Forfeiture Fund accounting system is brought into conformance with GAO standards as required by the Federal Managers' Financial Integrity Act.

Working With the New Inspector General

While Treasury's critical accounting, information, and internal control systems must be well designed and operated, their effectiveness and reliability must be assessed through periodic audits and evaluations. This can provide critical feedback to agency managers on how well these systems are achieving their intended objectives.

In October 1988, Congress enacted legislation to establish a new Presidentially-appointed Inspector General in Treasury. The new Secretary needs to ensure that the Inspector General's organization becomes operational in accordance with the recent legislation and to support this effort so that the Inspector General's office can carry out its responsibilities independently and objectively.

Related GAO Products

Managing IRS: Actions Needed to Assure Quality Service in the Future, (GAO/GGD-89-1, Oct. 14, 1988).

Computer Capacity: IRS Must Better Estimate its Computer Resource Needs, (GAO/IMTEC-87-5BR, Nov. 4, 1986).

Computer Support for Tax Processing Needs Continuing IRS Attention, (GAO/T-IMTEC-87-1, Feb. 6, 1987; GAO/T-IMTEC-88-1, Feb. 23, 1988).

ADP Modernization: IRS' Redesign of Its Tax Administration System, (GAO/IMTEC-88-5FS).

ADP Modernization: IRS' Tax System Redesign Progress and Plans for the Future, (GAO/IMTEC-88-23BR, Nov. 9, 1987).

Asset Forfeiture Programs: Progress and Problems, (GAO/T-GGD-88-41, June 23, 1988).

Managing the Costs of Government, (GAO/AFMD-85-35 and 35A, Feb. 1985).

Federal Financial Management Reform, (GAO/T-AFMD-88-18, Sep. 22, 1988).

Budget Reform for the Federal Government, (GAO/T-AFMD-88-13, July 7, 1988).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

United States General Accounting Office

GAO

Transition Series

November 1988

Education Issues

GAO/OCG-89-18TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Secretary-designate of Education

This summary report is one of a series that addresses major policy, management, or program issues facing the key agency heads of the new administration. These issues, the problems associated with each, and suggested actions were identified as a result of GAO work. Some issues are relatively new, while others represent long-standing and unresolved problems. What they have in common is that they will require attention by the Congress and the new administration.

The new president has pledged to improve the nation's educational system, and we believe that the actions we are recommending will strongly influence how well the Department carries out this mandate. Briefly, the issues in this report discuss the need to (1) reduce the cost and preserve the integrity of higher education programs, (2) enhance the federal role in elementary and secondary education programs, and (3) strengthen departmental management.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Reducing the Cost and Preserving the Integrity of Higher Education Programs 4

Enhancing the Federal Role in Elementary and Secondary Education Programs 12

Strengthening Departmental Management 16

Related GAO Products 20

Transition Series 21

Reducing the Cost and Preserving the Integrity of Higher Education Programs

The United States has the most successful higher education system in the world, and the federal government plays a major role in financing the education of young Americans through loan and grant programs that help millions of students each year. But, the mechanisms for providing financial aid to students are increasingly complex and cumbersome.

These mechanisms involve as many as 14,000 lenders, 8,000 schools, and 47 guaranty agencies that provide loan guarantees, pay lender claims, and ensure lenders follow proper procedures. This complexity, coupled with rising default costs, will present the new administration with a significant management challenge: Can high credibility and affordability be maintained in this vital link in the American education system? And if so, how? A priority for the Department should be to assert more effective management control of these important programs.

To enable this system to function effectively, the Secretary of Education should

- encourage better collection practices by lenders and guaranty agencies;

- increase incentives for lenders, agencies, and schools to protect federal financial interests;
- enhance program monitoring of these participants; and
- improve the quality of data the Department maintains on individual student loans.

Improve Collections and Reduce Defaults

The number of outstanding student loans insured by the Department has grown rapidly, increasing by 100 percent from 1982 to 1987. Overall loan activity was almost $12 billion in 1988 alone. But during the same period, defaults increased by 280 percent, with default claims exceeding $1.6 billion in 1988. Default rates are also substantial: Almost 20 percent of all students who received their last loan in 1983 had defaulted by September 1987. The rising cost of defaults continues to be a matter of concern to both the Congress and the administration.

We have reported on a variety of problems that lenders, guaranty agencies, and the Department have experienced in paying default claims promptly and collecting defaulted loans. We have also shown that certain institutions, particularly profit-motivated trade schools, do a poor job of managing their loan and grant moneys and have excessive default rates.

More specifically, we have reported instances where

- guaranty agencies fail to use available collection tools, such as the Internal Revenue Service tax refund offset, the resources of state offices, and contract collection agencies;
- lenders have not aggressively pursued defaulters, preferring to submit their claims and leave costly collection efforts to others;
- guaranty agencies have failed to follow their own collection standards and have not required lenders to do so; and
- educational institutions admit students who have little chance of success and who are highly likely to default on their loans.

Also, in an ongoing review of school default rates, we observed that the Department's data base had thousands of missing, incomplete, and inaccurate data entries. These data shortcomings hamper any effort by the Department to better manage its collections or reduce defaults. For example, a recent plan to eliminate from the loan program those schools with excessive default rates has been severely criticized, principally because of these data base errors.

Recent legislative and administrative changes aimed at enhancing collections and requiring more prudent behavior by lenders and guaranty agencies could help reduce default costs. The Department has shown an interest in making progress, but without continued commitment it will not be realized.

The Secretary should make default management a departmental priority and in particular (1) require that guaranty agencies use all major collection tools generally thought effective, (2) reject insurance claims where the guaranty agency or lender has not adequately met its collection obligations, (3) develop stronger sanctions—as recently proposed—for educational institutions that consistently have high default rates, and (4) develop and implement an improved loan portfolio data base.

Better Incentives Needed to Improve Performance

Further exacerbating the problems of affordability and credibility are weak incentives for the various participants (guaranty agencies, lenders, and schools) to meet their billing, collection, and other responsibilities.

The Department essentially relies on thousands of program participants involved in the loan programs to comply voluntarily with program requirements and to account for payments. However, our recent reports show that incentives for voluntary compliance are lacking. As a result,

- the bills that lenders send to the Department for interest subsidy payments are often inaccurate and overstated,
- guaranty agencies are sometimes slow to remit collection payments to the Department,
- lenders and guaranty agencies are not aggressive in collecting defaulted student loans, and
- educational institutions are often slow to refund tuition when students drop out.

Two examples illustrate this problem. Under current law, the Department can charge a lender interest on subsidy overpayments only for periods after it notifies the lender of the error. Similarly, its power to assess civil penalties is restricted to situations where it (1) demonstrates that the violations resulted from gross or willful negligence, and then (2) only after it notifies the lender and provides an opportunity to correct deficiencies. In essence, poor management is rewarded because, when overpayments are detected, lenders need to repay only the amounts erroneously billed, thereby receiving the use of interest-free funds.

Similarly, except in cases of gross negligence or willful misconduct, lenders are fully reimbursed by guaranty agencies for defaults, and these agencies in turn are generally fully reimbursed by the federal government. Consequently, neither lenders nor guarantors bear any substantial risk for loan losses, even though they control to a great extent the government's losses through their lending and collection practices. If these participants were to bear a greater proportion of the risk of loss when borrowers failed to repay, perhaps they would work more aggressively to collect these loans.

In our past reports we have made a variety of specific proposals to help solve these problems. Many of our suggestions have involved sanctions or incentives aimed at improving the performance of lenders and guaranty agencies. Some would require legislation, but others could be implemented by the Department.

The Secretary should work to improve incentives for lenders, guaranty agencies, and educational institutions to better protect federal interests and in particular seek legislation (and take other administrative actions) to allow the imposition of interest penalties where needed. The Secretary should also authorize limited risk-sharing with lenders and guaranty agencies in the Department's loan insurance activities.

Improve Program Monitoring

Inadequate monitoring by the Department also contributes to problems in the student loan program. We have reported during the last few years on a variety of problems the guaranty agencies and lenders have experienced in their operations that have gone undetected or uncorrected.

For example, we reported recently that the Department

- failed to detect millions of dollars in interest subsidy overpayments to major lenders and

- paid insurance claims on millions of dollars of defaulted loans, which we believe could have been rejected had deficiencies in lender and guaranty agency lending practices been detected.

We recognize that the monitoring of lenders and guaranty agencies is expensive and time consuming, but without it we believe these institutions will place a low priority on complying with program requirements. Even with limited resources, the Department could do a better job by developing strategies that involve coordination among federal, state, and private sector audit agencies and are more effective at targeting problem agencies and lenders for such reviews. Rather than continuing to deemphasize this important activity, as has been done in recent years, we believe it should be revived and strengthened.

The Secretary of Education should direct the Inspector General and other key Department officials to develop a strategy in which the Department's resources and those of guaranty agencies and private sector audit agencies are employed in an effective and coordinated effort to assure compliance with program objectives.

Enhancing the Federal Role in Elementary and Secondary Education Programs

The president-elect has emphasized the need to improve the American education system, and the Department will likely be judged on how well it provides federal leadership in accomplishing this goal, particularly in elementary and secondary education. In school year 1987-88, approximately $11.2 billion in federal funding was provided to support elementary and secondary education programs at the state and local levels. While this represents only about 6 percent of all funding for such educational programs, it is vitally important. These funds support programs that are the vehicles through which national goals are translated into change at the state and local levels. Our work shows that better policy guidance and better state program data could help the Department ensure that national goals are achieved.

Provide Better Guidance for Program Implementation

We identified numerous situations where better guidance to states from the Department could improve program operations.

For example, the Department has not given states specific guidance on the severity of handicapping conditions for eligibility for the state-operated Chapter 1 program, which provides $150 million annually to educate handicapped students. In the absence of guidance, a small number of states have qualified for greater funding by counting students with less severe handicapping conditions. Substantial funding for these states has come at the expense of other states that have counted only those with severe handicaps. In other words, the lack of guidance has allowed a minority of states to capture a disproportionate share of program funding.

Similarly, the Department has not done a good job of communicating policy guidance on matching requirements for grants under the $888 million federal vocational education program. As a result, federal funds targeted to needy students in certain locations are not being used because some state and local officials do not know that federal funds can be matched on a statewide basis. Some school districts have turned back funds because they could not provide the match, while other districts in the state had more than enough matching funds to make up the shortfall.

The Secretary needs to review state-administered education programs to assure that states and localities have sufficient federal guidance to properly implement the intent of the program legislation.

State Data for Congressional and Management Oversight Limited

The Department has generally failed to supply the leadership to assure the availability of nationwide education data needed to gauge the success of federal programs and determine the need for program changes. In our reviews of Department programs, we have repeatedly found old and incomplete data and inconsistent definitions that make state-to-state comparisons extremely difficult.

For example, in 1984, the Congress required state education agencies to prepare annual evaluations on the effectiveness of the $500 million Chapter 2 education block grant program. However, the Department provided no uniform data collection and reporting formats. As a result, states reported data using such a variety of formats and data categories that it was almost impossible to compare one state to another, let alone understand what was happening nationwide. State education officials have recently taken the initiative to cooperatively develop a reporting format, but many states have not yet followed the format to provide uniform national data to adequately evaluate the $2 billion appropriated since 1984.

Nationwide comparable data are also unavailable for management and oversight of vocational education programs, for which reauthorization hearings will begin in the spring of 1989. A computerized system for collecting nationwide data on local activities was terminated several years ago because of data accuracy and definitional problems. The Department has yet to develop a replacement system, although there is a broad consensus among state and local school officials that such a system is needed. Partly in response to this situation, the Congress funded a separate major evaluation study to prepare for reauthorization; the study has involved extensive primary data collection. Unless the Department acts to obtain needed information, the Congress is likely to continue mandating data collection as various programs are reauthorized.

At the same time that useful elementary and secondary education data were unavailable, the number of program evaluation studies done by the Department declined by over 70 percent. Moreover, existing evaluation data were often outdated, and the technical quality varied.

The Secretary should survey the information needed on major elementary and secondary education programs and work in cooperation with states and localities to develop standard reporting formats and definitions of data elements.

Strengthening Departmental Management

Effective management systems are critical to the Department's ability to accomplish its mission. We studied selected aspects of departmental management in recent years and plan to undertake a comprehensive review of departmental management within the next 2 years. Recent work, however, shows that benefits could accrue from making certain improvements now. These include

- developing an operational management system that sets a realistic number of major program priorities and tracks success against these priorities and
- improving financial management systems to address accounting and internal control weaknesses.

Increased Secretarial Involvement Could Improve Federal Impact

Traditionally, the Department has operated as a conglomerate of largely independent entities. Essentially, strategic planning and program management were delegated to various assistant secretaries. Broad philosophical guidance regarding Department programs was provided by the Secretary to senior officials, and the Secretary expected these officials to evaluate their own efforts toward achieving his goals and objectives. Senior officials were to ensure that their plans and activities reflected the concerns laid out in the Secretary's guidance.

Our recent management work shows that an effective management system has not been established for the Department. For example, senior officials have not generally established the subsidiary goals envisioned by the Secretary. We believe a management system is needed, and our work at other departments has shown that there are a variety of ways to structure and operate such a system. There are, however, certain critical elements, foremost of which is the need for strong secretarial involvement. Other critical elements include

- setting a reasonable number of major goals or priorities,
- monitoring progress against these goals, and
- providing periodic feedback on success to senior agency managers.

To enhance departmental leadership in American education, the Secretary should establish a secretarial management system.

Improve Financial Management

Key accounting and related internal control systems operated by the Department and certain schools have serious accounting and internal control weaknesses. As a result, (1) billions of dollars in federal funds and other financial resources are not adequately protected from fraud, waste, and mismanagement and (2) the Department's financial reports are unreliable, in part, because they are not derived from its accounting systems.

Our December 1987 report discussed (1) poor loan records, (2) inadequate accounting for and control over property, (3) accounting system weaknesses resulting in erroneous grant disbursements, and (4) an inadequate general ledger system. As a result, about $16 billion of federal funds and other financial resources are not adequately protected. Similar to the situation discussed earlier pertaining to program data, the financial data are also unreliable.

In the spring of 1988, the Department initiated efforts to modernize its financial management system. It also put in place a mechanism to track the development of this system and the upgraded projects.

The Secretary should ensure that these initial efforts continue, and develop the appropriate systems to address its accounting and internal control weaknesses.

Related GAO Products

Guaranteed Student Loans: Lenders' Interest Billings Often Result in Overpayments (GAO/HRD-88-72, Aug. 31, 1988).

Vocational Education: Information on the National Research Center's Grant Award Process (GAO/HRD-88-56, Jan. 29, 1988).

Guaranteed Student Loans: Potential Default and Cost Reduction Options (GAO/HRD-88-52BR, Jan. 7, 1988).

Financial Management: Overall Plan Needed to Guide System Improvements at Education (GAO/AFMD-88-15, Dec. 31, 1987).

Guaranteed Student Loans: Legislative and Regulatory Changes Needed to Reduce Default Costs (GAO/HRD-87-76, Sept. 30, 1987).

Defaulted Student Loans: Private Lender Collection Efforts Often Inadequate (GAO/HRD-87-48, Aug. 20, 1987).

Compensatory Education: Chapter 1 Participants Generally Meet Selection Criteria (GAO/HRD-87-26, Jan. 30, 1987).

Block Grants: Education Block Grant Alters State Role and Provides Greater Local Discretion (GAO/HRD-85-18, Nov. 19, 1984).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

☆U.S. Government Printing Office: 1988-225-357:39418

United States General Accounting Office

GAO

Transition Series

November 1988

Department of State Issues

GAO/OCG-89-19TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Secretary-designate of State

This transition report is one of a series that addresses major policy, management, or program issues facing many key agency heads in the new administration. Some of these concerns are relatively new, while others represent long-standing and unresolved problems.

This report identifies four important issues that we believe should be included in the agenda the Secretary of State and Congress set for the management of our nation's foreign affairs. They are (1) management deficiencies, (2) improving U.S. participation in United Nations organizations, (3) improving effectiveness of the international narcotics control program, and (4) improving administration of refugee programs.

These issues are discussed in detail in the reports listed at the end of this report.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Management Deficiencies 4

Improving U.S. Participation in United Nations Organizations 13

Improving Effectiveness of International Narcotics Control Program 16

Improving Administration of Refugee Programs 18

Related GAO Products 20

Transition Series 22

Management Deficiencies

Although senior State Department officials devote much of their attention to formulating and implementing U.S. foreign policy, they also are charged with the substantial responsibility for managing billions of dollars in assets around the world. For example, the Department manages thousands of properties in over 250 overseas locations and provides various types of administrative support services to more than 50 federal agencies overseas. High-level State Department officials have acknowledged that, historically, management and administration have not received high-level Department attention. The lack of specific accountability in administering State stewardship of resources, the lack of technically qualified personnel, and the normal rotation of foreign service generalists have contributed substantially to the continuing management shortcomings.

Over the past several years, numerous congressional hearings and reports by the State Inspector General and by GAO have identified major problems in State's management practices, resulting in fraud, waste, and abuse of resources. State officials have repeatedly promised corrective actions, but with the change in administrations, it is important to ensure that resource management receives adequate attention.

Managing State's worldwide operations should be considered as one of the most challenging jobs in either the private or public sector. The assignment of overseeing the network of far-flung diplomatic posts is loaded with tremendous opportunities. State needs to focus more attention on the use of its people and other resources in carrying out its stewardship responsibilities. Steps that State needs to take include the following.

- Assuring the timely completion and full implementation of the long overdue financial management system; without it, State has little chance of effectively managing its resources.
- Attracting, in sufficient quantities, qualified professionals in such technical fields as financial management, maintenance engineering, and real estate operations. The use of foreign service officers (generalists) to perform such specialized tasks for which they have little or no training, experience, or interest needs to be changed.
- Establishing short- and long-range plans to determine what legitimate resource needs exist in each bureau and at each overseas diplomatic post and how best to satisfy them. Such plans could be used to help

reduce the pressure for making costly changes to overseas construction projects merely to satisfy personal preferences of ambassadors or other officials.

- Enforcing compliance with existing federal requirements and vigorously implementing internal control procedures to provide the mechanisms to ensure accountability.

Strong Management Needed for Overseas Construction and Property

The State Department is responsible for managing billions of dollars worth of assets—embassies, office buildings, residences, motor vehicles, communications networks, security equipment, and office and home furnishings—so much that State does not know the general value of its property. It is buying and selling properties around the world on an ad hoc basis and has had a long-standing problem of poor recordkeeping and accountability.

Construction of buildings overseas over the years has encountered long delays, poor workmanship, and large cost overruns. The State Department's construction program has also been subjected to external pressures. For example, officials have intervened in the construction process to press for design changes as personal preferences. In other cases, political concerns about U.S.-host country relations have taken precedence over technical construction judgments (for example, the arrangements that substantially diminished U.S. ability to control Soviet work on the U.S. embassy in Moscow were hastily completed to coincide with a high-level, U.S.-Soviet meeting).

The State Department in recent years has also embarked upon a massive $2.1-billion, multi-year effort to strengthen the physical security of embassies and consulates around the world. The administration of this security enhancement program needs to be improved. For example, the actual costs of security upgrades at a number of embassies were almost double the original estimates. The security projects also generally have taken much longer to complete than originally planned because of numerous design modifications after construction was well underway, inadequate coordination among headquarters and overseas personnel, and the selection of contractors who lacked the skills and resources to promptly complete the projects.

Overseas Properties Need Improved Maintenance

Because of years of neglect, a serious maintenance problem now exists at a number of the 2,500 government-owned and long-term leased properties overseas.

This has occurred in part because responsibility for identifying maintenance needs typically rests with foreign service generalists at overseas locations who do not have the technical skills to assess maintenance problems. A scheduled cycle of preventive maintenance has not been used. State lacks sufficient facility management officers; as a consequence, maintenance problems are either not reported or not addressed until the facility requires major rehabilitation.

State officials acknowledge a serious maintenance backlog and estimate that about $1 billion would be needed to provide necessary maintenance and repairs. However, State has not sought sufficient funds to begin to deal with the maintenance backlog.

The result of State's long-standing failure to provide adequate maintenance has been that good buildings have deteriorated, decreased in value, and now require costly rehabilitation.

State Needs to Provide Adequate Overseas Administrative Support to Other Agencies at a Reasonable Cost

Since World War II, the State Department has provided administrative support services to other federal agencies overseas. This arrangement, which involves hundreds of millions of dollars annually, has been based on the premise that the interests of efficiency and economy are best served by expanding State's basic administrative capacity to include the common administrative requirements of other agencies, thus preventing duplication of staffing and resources. A factor which will have a broad impact on such support services relates to State's ability to satisfy the other agencies. Under legislation enacted in December 1987, other agencies will soon begin to pay the full cost of services received. This will significantly change the cost distribution system, since State for a number of years has been charging other agencies only for the incremental support costs incurred because of their presence overseas.

If State cannot provide adequate services at a reasonable cost, the other agencies that now voluntarily participate in the State support system will probably seek alternatives. The challenge to State and the other agencies will be to avoid (1) undermining previous efforts to curb the duplication of support capabilities, (2) creating competition among agencies for the same services in locations where limited alternatives exist, and (3) increasing costs to the government because economies of scale will be lost.

Improved Internal Controls Are Required

The State Department has broad-ranging, multi-faceted responsibilities for managing and accounting for funds used at over 250 overseas locations. Numerous transactions made in various local monetary currencies with fluctuating values increase the difficulties in properly controlling funds. Such a complex worldwide system requires sophisticated technical attention. Managing these resources is a significant challenge that must be met with experienced staffing and adequate equipment.

State needs to comply with numerous applicable laws, federal regulations, and/or its own directives in handling funds and other resources. Generally speaking, it has not applied some basic internal controls. There have been a number of cases of embezzlement and cashier fraud. We found State had not been performing physical inventories of such property as computers, security and communication electronic gear, vehicles, and office furniture and equipment; at some warehouses, controls were so lax that property could easily have been taken without detection. In some cases, other agencies have been charged improperly for overseas administrative support services because of the questionable allocation methods.

Since at least 1979, the Department has recognized that its current financial management system contains inherent deficiencies. A new system is scheduled to be fully operational in October 1989. The Foreign Service has had a chronic shortage of qualified budget and finance officers, and the Office for Financial Operations has had a long-standing vacancy rate for Civil Service employees in excess of 30 percent because of State's inability to hire and retain qualified personnel.

The authority and responsibility over many locations and levels of organizations are dispersed to such a degree that no one individual or organization is held specifically accountable for the stewardship of State's resources.

Priority attention should be given to improving financial accountability and resources management; doing so will provide substantial financial savings at a time when the Department is facing budget reductions. Continuing to place low priority on effective and efficient management creates a negative perception with the

Congress as well as with foreign governments and can hinder the achievement of U.S. foreign policy objectives.

Improving U.S. Participation in United Nations Organizations

Over the last several years serious concerns have been raised over the adequacy and effectiveness of financial and program management in the United Nations and its specialized agencies. We believe the United States can enhance the effectiveness of these organizations by (1) helping them regain their financial integrity, (2) improving their evaluation capabilities, and (3) bettering the system for managing U.S. participation in these organizations.

Since at least 1980, U.S. policy makers have been seriously concerned over uncontrolled budget growth in the U.N. organizations. Reductions in U.S. contributions have stimulated some financial reforms and limited budget growth. As a result, in September 1988 the United States announced that it would pay a portion on its arrears to the United Nations and that it would fully fund its future years' assessments. However, the United States has not yet developed a specific plan and program to implement the September 1988 policy announcement.

We believe that State needs to develop, in partnership with the Congress, a clear program which (1) consolidates the gains achieved from its withholding policy, (2) guards against potential program deterioration stemming from the current financial weaknesses, and (3) allocates arrearage payments to useful purposes.

The United States has long sought to strengthen the U.N.'s evaluation capabilities so that member nations can be assured that economy, efficiency, and effectiveness of U.N. programs and activities are maintained. Efforts to improve the U.N. Joint Inspection Unit and other internal evaluation systems have been productive, but more needs to be done to improve U.N. evaluation capability. We believe the Department needs to place renewed effort on strengthening and improving the U.N.'s external and internal evaluation systems.

For a long time, State has sought to develop a structured way for managing U.S. participation in international organizations. It established a management process to develop medium- and long-term objectives and an action plan for implementing them. In recent years this process has been downgraded to a more ad hoc method which emphasized a short-term approach to issues at hand, thus detracting from the usefulness of the process.

We believe a new administration should look closely at its organizational arrangement for policy development and program management and coordination, including the renewed use of action plans as a basis for establishing and implementing medium- and long-range plans for managing U.S. interests in international organizations.

Improving Effectiveness of International Narcotics Control Program

Drug abuse is a major international problem, and drug control has become a critical element of U.S. foreign policy. Despite increased U.S. assistance to cooperating countries' crop control and law enforcement efforts and increased eradication, narcotics production in 1987 exceeded 1986 levels substantially. Opium production increased by an estimated 19 percent, coca production increased from 7 to 12 percent, and marijuana production was up from 17 to 32 percent. Since U.S. demand amounts to a small percentage of worldwide supply of heroin, cocaine, and marijuana, these drugs are readily available to the United States, and street prices are down.

U.S. efforts to control illicit drug production in producing countries are inherently limited because (1) farmers can make far more income from illicit drug crops than from legitimate crops and alternative crops are not easily available, (2) governments in many source countries are weak and do not exert political or administrative control over all growers, (3) some major source countries are controlled by governments which are hostile to the United States, thus limiting U.S. influence over drug control, and (4) the set of source countries is not fixed, thus new producers emerge to replace suppressed production.

We believe that the Department of State can significantly improve the management of its international narcotics control program by streamlining its programming and management system as well as by instituting effective review and evaluation procedures. We recognize, however, that it is not likely that the intractable problems which limit a foreign government's ability to control narcotics production and trafficking can be easily overcome. Nevertheless, we believe that the new administration should thoroughly review its international narcotics control strategy to determine whether better ways can be found to implement it.

Improving Administration of Refugee Programs

Worldwide, there are approximately 13 million refugees. Historically, the United States has expressed a priority commitment to helping refugees. However, unnecessary administrative problems and bottlenecks are creating hardships on refugees.

State's administration of the U.S. refugee program has been adversely affected by the complex process of establishing policy advice and coordinating interagency actions to process overseas applications for refugees. Voluntary resettlement agencies have criticized the processing procedures as costly and outmoded and have cited budget problems and a chronic shortage of personnel.

According to State, "bureaucratic mistakes" contributed to the abrupt suspension in processing of applications for Armenian refugees. Surges in applications for refugees from the Soviet Union, Vietnam, and Kampuchea (formerly Cambodia) are expected to exacerbate the processing problems for the near future.

Improved accountability for refugee resettlement funds and better oversight of the private voluntary agencies which administer such funds are also needed. We believe that a new administration should review the effectiveness and efficiency of the Department's budgeting and monitoring of refugee program funds.

Related GAO Products

State Department's Management of Real Property (GAO/T-NSIAD-89-1, Oct. 5, 1988).

Overseas Construction: State Initiates Corrective Actions, But Improvements Still Needed (GAO/NSIAD-88-27, Oct. 30, 1987).

U.S. Embassy, Moscow: Why Construction Took Longer and Cost More Than Anticipated (GAO/NSIAD-88-23, Oct. 23, 1987).

Overseas Support: Current U.S. Administrative Support System Is Too Complicated (GAO/NSIAD-88-81, Mar. 25, 1988).

Internal Controls: State Department Needs to Improve Management of Travel Advances (GAO/NSIAD-88-178, Aug. 15, 1988).

Internal Controls: State's Controls Over Personal Property Management Are Inadequate (GAO/NSIAD-87-156, June 10, 1987).

United Nations: Progress to Strengthen U.N. Internal Evaluation System Has Been Slow (GAO/NSIAD-87-54, Jan. 14, 1987).

United Nations: Implications of Reduction in U.S. Funding (GAO/NSIAD-86-162BR, July 17, 1986).

Drug Control: U.S. Supported Efforts in Colombia and Bolivia (GAO/NSIAD-88-226, Nov. 1988).

Drug Control: U.S. International Narcotics Control Activities (GAO/NSIAD-88-114, Mar. 1, 1988).

Immigration: Studies of the Immigration Control Act's Impact on Mexico (GAO/NSIAD-88-92BR, Feb. 17, 1988).

Loans to Refugees: Status of Efforts to Improve Refugee's Transportation Loan Payments (GAO/NSIAD-87-64, Feb. 27, 1987).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

☉U.S. Government Printing Office 1988-225-357 39418

United States General Accounting Office

GAO

Transition Series

November 1988

Environmental Protection Agency Issues

GAO/OCG-89-20TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Administrator-designate, Environmental
Protection Agency

This report is one of a series that summarizes major policy, management, and program issues facing agency heads in the new administration. Through our work in these areas, we have identified many concerns—some relatively new, others long-standing.

This report on the Environmental Protection Agency (EPA) describes our concerns about (1) improving the overall management of the nation's environmental protection efforts (on the basis of the results of our general management review of EPA completed in August 1988), (2) improving the management of hazardous waste and the cleanup of abandoned waste sites, (3) creating a new policy to reduce ozone levels, (4) focusing increased attention on pesticide health and environmental assessments, and (5) developing a more comprehensive approach to cleaning up the nation's waterways. We also offer a wide range of observations and suggestions on how the Administrator of EPA can best address these concerns.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Improving Overall Environmental Program Management 4

Managing Hazardous Waste Programs Better 9

Creating a New Policy to Reduce Ozone Levels 16

Focusing Increased Attention on Pesticide Health and Environmental Assessments 20

Developing a Comprehensive Approach to Control Surface Water Pollution 23

Related GAO Products 25

Transition Series 27

Improving Overall Environmental Program Management

Significant inroads have been made over the past 20 years in addressing a host of environmental problems that have plagued the nation. However, environmental inquiry continues to identify additional threats to human health and the environment, such as indoor radon and stratospheric ozone depletion. And, it becomes increasingly evident that solutions to such problems are more complex than initially envisioned. Better management of the nation's environmental programs, requiring the efforts of both the Environmental Protection Agency (EPA) and the Congress, will be needed to meet the challenges in the years ahead.

Focus on Measurable Results

The nation's environmental programs must be managed with greater emphasis on achieving measurable environmental results.

Although managing for measurable environmental results is an agency goal, EPA has not operated in this manner. Generally, it measures success in terms of accomplishing program activities, such as the number of inspections performed or enforcement actions taken against facilities required to comply with environmental regulations. EPA does not, however, take the additional step of linking the results of these activities to changes in environmental conditions. Without an environmental results-oriented focus, it is difficult to evaluate the impact that EPA programs and other initiatives are having in correcting environmental problems.

In order to manage for environmental results, EPA needs to

- emphasize environmental monitoring to develop better information on current and future environmental conditions and
- undertake and/or expand research to determine the environmental dangers and health risks posed by various sources of pollution.

EPA also needs to implement a multimedia approach in monitoring and evaluating changing environmental conditions. Traditionally, environmental programs have been crafted and managed along specific media lines—air, water, hazardous waste—with little emphasis on the pollutant relationships among media. This approach hinders efforts to develop environmental information from a multimedia perspective. Such a perspective is needed, for example, because efforts to improve the quality of the nation's waterways may be dependent on reducing air pollutants contributing to the formation of acid rain that may later fall into rivers and streams. In establishing environmental results measures, EPA needs to determine the interrelationships among media and employ multimedia environmental monitoring to capture the results of the nation's environmental initiatives in a more comprehensive manner.

Link Goals to Planning, Budgeting, and Financial Management Systems

Results-oriented environmental goals should be ranked in order of priority and become the basis for EPA's planning and budgeting activities, as well as be linked to EPA's financial management system.

Currently, EPA's planning function is not well linked to its budgeting process; therefore, there is no assurance that resources will be allocated in a manner consistent with program priorities. Our general management review of EPA indicated numerous cases in which items included in the agency budget did not reflect priorities established through the agency's planning system. Multimedia considerations also need to be reflected in the budget development because, for example, improvements in water quality may depend on initiatives to control surface water runoff from hazardous waste disposal sites.

EPA is currently developing an integrated financial management system that also should be linked to its planning system. EPA should provide sustained leadership and maintain a high priority for this undertaking because of the potential problems in developing financial management systems.

The Congress recently required annual audits of two major EPA programs, and we initiated a comprehensive audit of EPA's financial statements in June 1987. Such efforts should provide the Congress and the public with the financial information necessary for responsible oversight.

Develop a More Effective EPA-State Partnership

A new EPA-state partnership is needed for carrying out the nation's pollution abatement efforts.

EPA is held accountable to the Congress for managing the nation's environmental activities; however, most program implementation activities are carried out by the states, with funding and oversight provided by EPA. Many states want increasingly more independence, maintaining that too much of their time is consumed in responding to EPA oversight requirements. Their performance varies considerably, however, which limits the amount of autonomy that EPA has allowed.

Recertification, an approach in which EPA would periodically conduct comprehensive evaluations focusing on results-oriented achievements, would give states more implementation responsibility and allow them to concentrate more resources on correcting actual pollution problems. This approach would also provide periodic opportunities for EPA to assure itself that the states are carrying out the nation's environmental programs effectively.

Managing Hazardous Waste Programs Better

Programs to control currently generated hazardous waste and to clean up waste from old, inactive waste sites have not been well managed. Progress has been limited, and accomplishments have fallen short of expectations in both the private and federal sectors.

Improving Focus and Direction of Today's Hazardous Waste Program

Problems in dealing with currently generated hazardous waste underline the need for improved program focus and direction.

EPA has made limited progress in

- determining which wastes are hazardous and need regulating and
- getting hazardous waste handlers to comply with regulatory controls.

EPA does not know whether it has identified 90 percent of the hazardous waste that needs to be regulated or only 10 percent. This uncertainty is due to EPA's lack of focus and changing approaches in its waste identification efforts.

We have issued several reports that show widespread and persistent noncompliance with hazardous waste regulations, such as ineffective groundwater monitoring for hazardous waste facilities. EPA estimates that about half of the 5,000 facilities that treat, store, or dispose of hazardous waste may require action to clean up and correct existing deficiencies at a cost of more than $22 billion. One reason for the lack of success is not holding enforcement officials accountable for attaining compliance. Additionally, we have reported that EPA has made limited progress in getting generators to reduce the volume and toxicity of hazardous waste being produced nationwide.

We recommended in 1988 that EPA establish specific, measurable, long-term goals for its waste management program and strategies for accomplishing them. To ensure that congressional intent is not overlooked in the process, EPA should consult with the Congress in developing its strategies and periodically report back on its progress in achieving its goals.

Improving Superfund's Management Strategy

EPA needs to develop a more effective strategy for its Superfund program that ensures that sites are cleaned up as quickly as possible and that responsible parties bear their fair share of the cleanup costs.

The cleanup of old, inactive hazardous waste sites under Superfund has been slow, and the potential extent of contamination may have been underestimated. As of September 1988, EPA had identified more than 29,000 sites nationwide that could require cleanup under Superfund; we have estimated that as many as 425,000 sites may exist. Of the approximately 9,000 sites it has inspected, EPA believes that 1,177 should receive priority cleanup attention.

Cleanup work, funded mostly by EPA, has been started at 201 of the 1,177 sites and has been completed at only 27. Thus far, EPA has obligated about one-third of the funds (approximately $3.5 billion of $10.1 billion) authorized to clean up sites when private parties responsible for the contamination are unwilling or unable to do so.

The program has come under fire from many sources who have complained that

- EPA's process for assessing pollution and designing cleanup remedies at sites is too time-consuming,
- federal money is being spent unnecessarily because EPA has not aggressively pursued responsible private parties to pay cleanup costs, and
- the few cleanup remedies EPA has selected do not ensure that the threats posed by

contaminants will be eliminated permanently.

We have reported that EPA needs to strike a better balance between assessing and cleaning up existing sites and ensuring that reasonable efforts are being made to uncover, inventory, and assess potential new sites. We have also reported that EPA has not sufficiently controlled the costs of contractors who do most site assessments and devise cleanup strategies for EPA and that EPA's Superfund work force is inexperienced and employee turnover high. In view of these problems and the progress made to date, it is doubtful that the Superfund program, as currently operated, will ever achieve the cleanup of all hazardous waste sites.

Encouraging Federal Sector Compliance

Federal agencies should set the example for hazardous waste management.

The federal sector, which might be expected to be a model hazardous waste manager, has, in fact, been slow to comply with regulatory requirements. In a 1986 review of federal facilities that handle hazardous waste, we found that at least half of the facilities inspected had violated hazardous waste regulations; some were out of compliance for more than 3 years.

In addition, 62 federal facilities have been included on EPA's Superfund list of priority sites for cleanup. A congressional timetable for federal agency action has prompted the agencies to begin work; however, most are still in the very early stages of the cleanup process. Although the extent and costs of federal facility cleanup have not been fully determined, they could be substantial. Estimates put costs as high as $14 billion at the Department of Defense and $65 billion at the Department of Energy.

A major stumbling block that has slowed federal sector compliance is EPA's inability to require other federal agencies to comply with hazardous waste regulatory requirements. The administration has not given EPA the authority to direct other federal agencies to meet regulatory requirements. Several pieces of legislation that would have expanded EPA's authority in this area were considered, but not enacted, by the 100th Congress.

Evaluating Threats From Nonhazardous Waste

EPA needs to increase its evaluation of nonhazardous waste to determine what actions are necessary to protect human health and the environment, and the Congress and administration need to determine what the federal role should be in the control of nonhazardous waste.

Mounting evidence indicates that wastes currently considered nonhazardous—such as medical, household, and municipal wastes—the disposal of which is not federally controlled, may not be adequately managed to protect the public and environment. For example,

- some of today's Superfund sites include landfills that have accepted municipal waste, and
- EPA's study of 6,000 municipal landfills shows that such landfills do pose environmental threats, such as contaminating groundwater.

Medical waste washing up on our nation's beaches raises serious questions about the regulation of these wastes, which is currently left to the states.

Issues the Congress and administration will have to address include

- the dangers posed by nonhazardous wastes and waste sites,
- the regulations necessary to protect human health and the environment, and

- the impact that increased EPA nonhazardous waste responsibilities will have on current EPA resources devoted to hazardous waste.

Creating a New Policy to Reduce Ozone Levels

A new ozone policy is needed for reducing ground-level ozone to environmentally safe levels.

While progress has been made in reducing ozone levels, most metropolitan areas have yet to meet the national safe ozone level established by EPA. In fact, about 75 million people live in areas in which the amount of ground-level ozone—a key ingredient of smog—is considered unsafe for human health and the environment. Some areas, such as Los Angeles, reach levels as high as two or three times the safe level because of large populations, industries, and weather factors that are conducive to ozone formation.

EPA requires localities that have not attained the safe ozone level to establish control measures to reduce pollutant emissions that contribute to the formation of ozone. In some areas, planned reductions have failed because

- the required control measures were not implemented,
- the measures implemented were not enforced, and/or
- such measures were not as effective as envisioned.

Some states and localities find it difficult to reach a proper balance between the environmental benefits of ozone reductions and the economic and lifestyle changes necessary to achieve them. Such changes include reducing automobile use or operations at manufacturing plants to limit the pollutants that contribute to ozone formation. Also, ozone reduction measures are costly; EPA estimates future nationwide costs could reach $10 billion annually.

The Congress extended its deadline for attaining the safe ozone level from the original deadline of 1975 to 1982 and allowed additional extensions possible to 1987. It also established economic sanctions that could be imposed on areas not meeting the extended deadline, such as a ban on construction of facilities that would be major contributing sources of ozone pollution. The use of sanctions, however, has been controversial, and on two occasions the Congress prohibited EPA from applying them.

In amending the Clean Air Act, the Congress has yet to reach a consensus on such issues as

- the additional time that areas will need to reach attainment;

- additional control measures that should be mandated at a national and/or local level; and
- economic penalties, such as withholding highway funds, that could be imposed against areas that do not make reasonable efforts to control ozone.

In the absence of congressional direction, EPA has proposed a post-1987 policy that would, among other things, extend the ozone attainment deadlines, waive certain economic sanctions, and continue use of other sanctions. Although EPA's actions are understandable, we do not believe that it has the legislative authority to carry them out.

As we recommended in a January 1988 report, the Congress needs to develop, with EPA's input, a legislative framework that

- establishes a strategy that places localities into different categories on the basis of the severity of their ozone problem and sets new attainment deadlines for each category and
- specifies the conditions under which sanctions will apply and the extent to which

EPA has discretion in applying such sanctions.

EPA then needs to strengthen its oversight procedures to make sure this policy is implemented. Without such action, the prospects for making significant inroads against the ozone problem are not very encouraging.

Focusing Increased Attention on Pesticide Health and Environmental Assessments

Increased management attention needs to be focused on EPA's program to assess the long-term health effects of the 50,000 pesticide products currently available for public use.

Most of the approximately 50,000 pesticide products licensed for sale on the open market have not been assessed to determine their long-term health effects on human health and the environment. EPA's program to assess these products, which was launched in 1972, has not produced the results that were initially envisioned. Currently, only 11 of 600 active ingredients used in pesticides (the chemical that kills or controls a pest) have been assessed. At this pace, estimates are that an additional 30 years would be needed to complete the process.

However, the Congress, through 1988 amendments to the Federal Insecticide, Fungicide, and Rodenticide Act, has refocused EPA's assessment program. EPA has been given additional funding for conducting assessments and 9 years for completing the task.

Because EPA has not been successful in meeting deadlines or implementing pesticide reforms in the past, extraordinary leadership is needed to meet the congressional mandate. To effectively implement the accelerated assessment program, EPA needs to, among other actions,

- concentrate on meeting each deadline in the act as it comes due rather than the final 9-year deadline (once intermediate deadlines are missed, it will be nearly impossible to make up the lost time, given prior agency performance);
- hire and train high-caliber staff to review the volume of industry-submitted health and environmental studies that will be needed to make regulatory decisions on each pesticide ingredient; and
- establish quality controls to ensure that industry-submitted studies are reliable, valid, and complete and that EPA's audits and scientific reviews and assessments of the studies are independent, thorough, and accurate.

Several complex and controversial issues that remain unresolved will challenge EPA's best leadership. Among the issues yet to be resolved are

- determining the synergistic effects of combining more than one active ingredient in a product (EPA is generally only assessing the health effects of individual active ingredients);

- assessing the health and environmental effects of about 1,200 inert ingredients in pesticide products that propel, dilute, or stabilize the active ingredients (EPA has only just begun work in this area); and
- whether, and how, the public should be informed about which products have been fully assessed for long-term effects (EPA has not addressed this issue at all).

Developing a Comprehensive Approach to Control Surface Water Pollution

A more comprehensive approach to controlling surface water pollution that recognizes nonpoint sources of pollution as well as point sources is needed to improve the quality of the nation's waterways.

Billions of dollars have been spent to reduce point-source water pollution (pollution from a specific point of discharge) from municipal sewage treatment plants and industrial plants. Yet states continue to identify significant portions of waterways that are still not fit for designated uses such as swimming and fishing. Current thinking is that even if further improvements occur in point-source controls, pollution from nonpoint sources (no specific point of discharge) would still leave many of our lakes, rivers, and streams polluted.

Pollutants from nonpoint sources now represent the major environmental threat to the nation's surface waters. Examples of nonpoint sources include farmlands, mines, or streets from which runoff caused by rainstorms can carry pesticides, oil drippings from vehicles, and other harmful substances into our waters.

Because nonpoint source pollution can occur anywhere along a body of water, it is very difficult to identify its point of entry. The best solution is to prevent or limit it from reaching the water through proper land management techniques, such as terracing farmland on a hillside to limit the runoff of pesticides into a stream.

Available information shows that identifying and controlling runoff are possible. Moreover, the results of one study of a particular reservoir suggest that in certain situations it may be less expensive to control nonpoint sources than to adopt additional point-source controls. In response to this study, local governments developed a comprehensive approach to controlling both point and nonpoint sources that is expected to ensure environmental progress while allowing for economic growth.

The Congress and EPA have provided limited funding for controlling nonpoint sources. Currently, no estimates exist on the potential cost of a comprehensive national program that recognizes the need to control nonpoint sources as well as point sources of pollution. Costs to collect and treat storm water runoff from urban streets, for example, could be substantial. On the other hand, nonpoint source control may be the only alternative to deal effectively with many of our remaining heavily polluted waters.

Related GAO Products

General Management	Environmental Protection Agency: Protecting Human Health and the Environment Through Improved Management (GAO/RCED-88-101, Aug. 16, 1988).
Hazardous Waste	Hazardous Waste: New Approach Needed to Manage the Resource Conservation and Recovery Act (GAO/RCED-88-115, July 19, 1988).
	Superfund: Extent of Nation's Potential Hazardous Waste Problem Still Unknown (GAO/RCED-88-44, Dec. 17, 1987).
	Hazardous Waste: Federal Civil Agencies Slow to Comply With Regulatory Requirements (GAO/RCED-86-76, May 6, 1986).
	Superfund: Civilian Federal Agencies Slow to Clean Up Hazardous Waste (GAO/RCED-87-153, July 24, 1987).
	Superfund Contracts: EPA Needs to Control Contractor Costs (GAO/RCED-88-182, July 29, 1988).
	Superfund: Improvements Needed in Work Force Management (GAO/RCED-88-1, Oct. 26, 1987).
Air	Air Pollution: Ozone Attainment Requires Long-Term Solutions to Solve Complex Problems (GAO/RCED-88-40, Jan. 26, 1988).

	Air Pollution: Efforts to Control Ozone in Areas of Illinois, Indiana, and Wisconsin (GAO/RCED-88-46BR, Jan. 29, 1988).
Pesticides	Pesticides: EPA's Formidable Task to Assess and Regulate Their Risks (GAO/RCED-86-125, Apr. 18, 1986).
Water	Water Pollution: Efforts to Clean Up Michigan's Rouge River (GAO/RCED-88-164, Aug. 10, 1988). The Nation's Water: Key Unanswered Questions About the Quality of Rivers and Streams (GAO/PEMD-86-6, Sept. 19, 1986).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

☆U.S. Government Printing Office: 1988-225-357:3941

United States General Accounting Office

GAO

Transition Series

November 1988

Department of Labor Issues

GAO/OCG-89-21TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Secretary-designate of Labor

This report highlights major policy, management, or program issues that need attention by the Secretary of Labor. Some are relatively new, while others represent long-standing and unresolved problems. If these issues are addressed properly, the Secretary will better accomplish the Department's key responsibilities for ensuring safe and healthful workplaces and for promoting the welfare of wage earners, and will improve the overall management of the Department.

Specifically, the issues we believe the Secretary should place the most emphasis on are (1) improving the Occupational Safety and Health Administration's enforcement program, (2) enhancing the use of Job Training Partnership Act resources, (3) developing a strategy to address recessionary problems, (4) implementing the new dislocated worker assistance program, and (5) sustaining Department management improvements. These issues were identified through our general management review of the Department of Labor as well as other work we have done at the Department.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Improve OSHA's Enforcement Program 4

Better Target Job Training Resources 9

Develop a Contingency Plan to Address Recessionary Problems 14

Assure Effective State Implementation of Dislocated Worker Rapid Response Program 19

Sustain Management Improvements 22

Related GAO Products 26

Transition Series 28

Improve OSHA's Enforcement Program

The Congress created the Occupational Safety and Health Administration (OSHA) to assure Americans a safe and healthful workplace, but this goal is not being achieved in many dangerous industries. Each year, about 10,000 men and women die from work injuries and another 50,000 to 70,000 die from occupational disease. More than 5 million workers are injured each year at work, and 350,000 illnesses are attributed to work-related causes. The economic cost to the nation is in the billions.

The Congress, labor unions, and the public generally believe this national safety record can be improved, and in that context OSHA's credibility continues to be questioned. Decisive action by the Secretary of Labor should help restore confidence in OSHA's programs. Our work suggests several important areas that deserve attention:

- developing a more timely process for issuing safety and health standards,
- ensuring the accuracy of data used for targeting inspections,
- improving the monitoring of state programs, and

- enhancing coordination with other agencies having worker protection responsibilities.

Expedite Standard-Setting

OSHA issues standards to protect workers from safety and health hazards. The standards spell out the conditions, practices, means, methods, operations, and procedures needed for a safe and healthful workplace.

Our 1985 management report on the Department of Labor showed little public confidence in OSHA's standard-setting because the process was so slow. Today, OSHA is issuing a few more standards each year but is taking more time to issue them. As of May 1988, 52 percent of OSHA's unissued standards had been in process for more than 4 years compared with 15 percent in May 1985.

OSHA has attempted to expedite the standard-setting process through innovations such as "mediated rulemaking." In this mediated process, representatives of affected parties attempt to reach consensus on the text of a proposed rule. But this has not quickened the standard-setting process. For example, OSHA began its mediated rulemaking process for the chemical MDA in October 1985 and has yet to issue its final standard. The time for issuing the MDA standard could possibly be one of OSHA's longest. In essence, the current standard-setting process is cumbersome and slow, yet the number and kind of workplace hazards grow and change rapidly each year. The Secretary needs to evaluate the mediated rulemaking process and other alternatives in a search for ways to speed up its standard-setting process.

Better Data Needed for Targeting Inspections

Inadequate injury and illness data are undermining OSHA's enforcement activities. OSHA uses employer-maintained injury and illness data to target its workplace inspections. Because of inaccuracies in these data, it has little assurance that inspection resources are being targeted to the most hazardous establishments. Our study of this issue and a recent OSHA-Bureau of Labor Statistics study show that there are steps that can improve the accuracy of the data.

The Secretary should implement a quality assurance program to improve the accuracy of employer injury and illness data used to target inspections.

Enhance Monitoring of State Programs

The Occupational Safety and Health Act of 1970 encourages states to develop and operate their own occupational safety and health programs, which 25 states and territories currently do. OSHA is required to assure that state programs are at least as effective as OSHA-administered programs in providing safe and healthful workplaces. However, it has failed to do so.

In April 1988, we testified that OSHA's approach to monitoring and evaluating the states' programs has serious shortcomings. We recommended that OSHA (1) articulate standards for desired state program performance levels and consider providing incentives for states to attain these levels, (2) require states to establish quality assurance programs and periodical' review these efforts, and (3) help states evaluate their programs' impact on worker safety and health.

The Secretary needs to assure these changes are made to improve OSHA's monitoring of state enforcement programs.

Strengthen Working Relationships

OSHA has not established effective working relationships with other Labor Department agencies and with other federal agencies that have worker protection responsibilities. OSHA and these other agencies (1) put little emphasis on referring likely violators to each other and (2) rarely engage in joint enforcement efforts aimed at multiple labor law violators.

For example, within the Department of Labor, although there are reports of a growing number of businesses that regularly violate both wage and safety and health laws, OSHA and Labor's Wage and Hour Division rarely refer potential violators to each other. Also, there is no agreement between the Environmental Protection Agency (EPA), which regulates the cleanup of toxic substances, and OSHA, which protects workers in hazardous areas, providing for EPA to notify OSHA when a chemical spill occurs.

The Secretary should ensure that OSHA better coordinates its enforcement activities with other worker protection agencies.

Better Target Job Training Resources

The Job Training Partnership Act (JTPA) is the nation's premier job training effort. Title II-A of the act is funded at about $1.9 billion a year to serve economically disadvantaged adults and youth who need training to obtain a job. Annually, programs under title II-A serve about 6 percent of those who are both eligible and likely to be in the job market. Title II-A has purposely been organized to encourage maximum flexibility at the local program level. This flexibility has encouraged the design of innovative approaches to meeting the job training needs of individual communities. However, our work leads us to believe that it may now be time for increased federal leadership in making decisions on whom to serve, what mix and intensity of services to provide, and how to deal with potential program abuses. In particular, we believe the Secretary should:

- encourage the local programs to provide more intensive JTPA training to those most in need,
- develop program performance data and evaluate the results of this more targeted approach, and

- ensure that the length of JTPA-funded on-the-job training is commensurate with the skill levels of the jobs being subsidized.

Little Evidence of Targeting to Those Most in Need

For the most part, the law provides only general guidance about who is to be served—namely those who can benefit from and are most in need of training. No regulations or guidance defines this further, essentially leaving it to the states and local programs to decide who gets help.

Some members of Congress and employment and training professionals are concerned about whom the program serves. One point of view is that JTPA's lack of guidance, limited resources, and emphasis on meeting performance standards push local programs to select eligible applicants who need only limited, short-term services and who are likely to be counted as a success. Some argue that this excludes individuals with a need for more intensive, long-term training. Others believe that this selection practice is appropriate and lets the program successfully serve a larger number of individuals at lower cost. Substantive analysis of this issue has been impossible because the data that are collected at the national level on JTPA provide only limited information on who is being served, what services they receive, and what outcomes they attain.

Better Target Job Training Resources

Our analysis of the data we collected on adult participant characteristics, services, and outcomes suggests that program resources could be better targeted to reach those who might obtain the greatest benefit from job training and assistance.

We compared the training experiences of people whose characteristics suggested they were more or they were less ready to enter the labor market successfully and found that JTPA did not target services to any particular group. Essentially, each was served in rough proportion to its existence in the eligible population. Indeed, those who probably need more help to get good jobs tended to receive less intensive training under JTPA and, therefore, receive proportionately less of the JTPA funds.

Based on our analysis, it appears that the program can be effective in preparing adults for moderate and high-skill jobs. Specifically, the majority of those trained for higher skill occupations were placed in higher skill jobs. Similarly, the majority of those trained for moderate and lower skill jobs received such jobs. Most importantly, when those who were less ready to enter the labor market received significant training, they also seemed to get better jobs and higher pay than those who received less assistance. What we cannot tell based on available information is the extent to which these results may be influenced by local programs selecting candidates for occupational training who, for reasons we could not measure (such as individual motivation), are more likely to be successful.

However, we believe the information is adequate to justify experimentation with greater targeting and increased emphasis on more intensive interventions. We have suggested to the Congress that they may wish to consider whether additional guidance on program targeting and data collection is desirable.

Meanwhile, the Secretary should encourage the use of more intensive program interventions by local service deliverers and evaluate the benefits of more extensive and higher skill training, particularly for those in the greatest need of training. This will require the development of program data on who is being served, what services they receive, and what outcomes they attain.

On-the-Job Training

Over 40 percent of on-the-job training in JTPA is in lower skill occupations, such as custodian, housekeeper, and dishwasher.

While such training may be good for certain individuals, much of it was very likely too long. In fact, we estimate that over half of the on-the-job training contracts in lower skill jobs provide for excessive training periods.

Because JTPA reimburses employers for a portion of the on-the-job training wages, excessive training increases training costs—in essence providing a wage subsidy to employers. Such subsidies may be appropriate for certain difficult-to-place participants, but we found that most of these low-skill positions with long training contracts were filled by participants who are already fairly well prepared for jobs.

The Secretary should take steps to assure that the length of on-the-job training for which JTPA pays is commensurate with the skill level of the job.

Develop a Contingency Plan to Address Recessionary Problems

Although the United States is enjoying its most sustained peace time economic expansion, the potential is ever present for the expansion to end, unemployment to rise, and the nation to enter a recession. The problems facing the federal government during a recession include providing income support to the unemployed and stimulating economic growth. The Department of Labor will have an important role in addressing these problems. How well the Department performs will depend, in part, on how well it has prepared itself for its role.

The Department needs to act now to be prepared for a future recession. Desirable actions include building adequate reserves in the Unemployment Insurance system, developing a strategy to provide direct income assistance to the unemployed, and developing a strategy to assist states in dealing with the increased workload for programs serving unemployed workers.

Build Adequate Unemployment Insurance Reserves

During recessions, the Unemployment Insurance system helps to stabilize the economy by maintaining unemployed workers' purchasing power through temporary and partial replacement of lost income. However, the system's financial condition has been eroded over the past 20 years. Despite the extended economic expansion, many state trust funds have inadequate reserves and many will likely be unable to pay benefits during a future recession without borrowing billions from the federal government. Repayment of these federal loans will in turn create large financial burdens on states. During past recessions, many states responded with benefit cuts and increased employer taxes. Such responses reduced the program's effectiveness as a source of income support for the unemployed.

Unless steps are taken immediately to make state reserves more adequate, the federal borrowing triggered by the next recession is likely to cause another round of benefit cutbacks among the states, further eroding the adequacy of the Unemployment Insurance program.

To assure that the Unemployment Insurance program continues to be an effective source of assistance to those who have lost their jobs, the Secretary needs to act now to ensure that states build and maintain adequate reserves.

Anti-Recessionary Actions Should Be Quick-Acting and Targeted

If history is any guide, components of an anti-recessionary response would very likely include a jobs program and potentially some form of income replacement assistance provided through Department-administered programs. The principal objective would be to provide a source of income to unemployed workers. The Department has many options to consider as it evaluates appropriate program strategies, including a public employment program, increased use of on-the-job training in its training programs, enhanced Unemployment Insurance benefits, and providing stipends for JTPA participants. The vivid lessons of the past have shown that, regardless of the option selected, any anti-recessionary program that is to be successful must have certain attributes, including being quick-acting, targeted at those who need it most, and simple to administer.

Jobs programs mean different things to different people, however. To some they mean increased federal spending on public works projects resulting in more private sector employment. To others they mean more public sector employment programs where federal, state, or local governments provide stipends to particular groups or hire workers directly. We studied the federal response to the 1981-82 recession, the Emergency Jobs Appropriations Act of 1983, which was designed to be a quick-acting public works program. Unfortunately, we found that it was neither very quick, nor very effective in creating jobs. About half the program's funds were spent within 2-1/2 years following the end of the recession, and no more than 35,000 jobs were created at any one time. In addition, much of the impact came much too late to be of value in countering the worst effects of the recession.

In contrast, the experience of the 1970's showed that public service jobs programs can be quick-acting, targeted at the most affected populations, and simple to administer. Such an approach has been shown to be an effective way to provide income assistance to large numbers of unemployed workers. Similarly, providing stipends to participants in JTPA training programs or increasing the use of on-the-job training could potentially provide income assistance quickly to unemployed workers, while utilizing existing delivery mechanisms. Special federally sponsored extended or supplemental Unemployment Insurance benefits also satisfy the criteria for anti-recessionary income assistance.

Some of the institutions and programs used in the past to operate direct public employment programs, however, no longer exist, and other income replacement approaches would require legislative action. Advance planning will be necessary to establish appropriate service delivery mechanisms and program specifications and to develop legislative proposals. In addition, many of the Department's programs will be substantially impacted during a recession, such as the Unemployment Insurance program, the employment service, and major job training programs. Where necessary, contingency planning should be started with the assistance of the states so that program expansions, especially among programs operated by the states, can be handled smoothly when the need arises.

The Secretary should begin now to explore options for implementing recession assistance to both workers and the states.

Assure Effective State Implementation of Dislocated Worker Rapid Response Program

The 1988 trade act established the Economic Dislocation and Worker Adjustment Assistance program to provide for improved reemployment assistance to dislocated workers. This program builds upon the basic approach originally established under title III of JTPA. The new program places more emphasis on training and early intervention and increases the availability of assistance statewide. However, the design of the new program does not directly address certain factors identified in our evaluations of title III programs as being associated with success. The Department of Labor should take action now to require that states incorporate these factors in their assistance plans.

Factors Associated With Success

Our reviews of JTPA dislocated worker assistance found that the most successful projects had certain similar characteristics. In general, the successful projects dealt with the needs of dislocated workers on an individual basis, tailoring assistance strategies to particular workers based on their own skills and experience, and also took into account local labor market characteristics. In addition, to ensure that retraining was completed, dislocated workers often benefited from persistent encouragement and personal support on the part of project staff. This often included help with solving training and income-related problems without which workers might drop out of the program.

As states put together their plans for the new dislocated worker assistance program, the Secretary should require that those factors associated with success be included in those plans.

Respond Rapidly to Serve Dislocated Workers

The new dislocated worker program mandates that statewide dislocated worker offices be established that can respond rapidly, on site, to permanent closures and mass layoffs. The state offices are required to work with employers and labor representatives to facilitate worker reemployment assistance. Getting to workers quickly when (and generally before) they become unemployed is key to providing timely and effective reemployment assistance.

Even though enactment of the advance notice requirement calls for employers to provide 60 days' warning of a closure or mass layoff, most dislocated workers will not receive such notice because smaller employers (the majority) and those with partial layoffs are generally not covered, and exclusions for unforeseen business circumstances will exempt others. Finally, 60 days' notice will often be insufficient to develop a worker adjustment strategy

Assure Effective State Implementation of Dislocated Worker Rapid Response Program

unless prior planning has occurred or an existing program is utilized.

Therefore, to have an effective rapid response capability, states should have a comprehensive and flexible program in hand and ready to administer at any site on short notice. This probably implies prearrangement of service delivery contractors who can provide needed training and assistance when limited local infrastructure exists. Experience shows that often a few days is all the time available to get a dislocated worker assistance project in place.

The Secretary should require that states include in their plans explicit strategies for providing rapid reemployment assistance, particularly where advance notification is not provided or is very limited.

Sustain Management Improvements

Because good management is essential for achieving agency missions and goals, GAO has made a series of studies of the basic administrative and management processes of major federal departments and agencies. In October 1985, we reported on management problems at the Department of Labor and made specific recommendations for dealing with them.

The Department has made excellent progress in rectifying these problems; in particular, strengthening Secretarial direction; doing required mine inspections; and improving management of its information resources, work force, and financial operations. But sustaining these efforts and achieving the full benefits of actions taken will require the attention and commitment of the new Secretary and senior Department officials. Also, the new Secretary should focus on establishing a departmental evaluation program.

Maintain Strong Secretarial Leadership

The Secretary's role is critical to effective departmental management. In particular, the Secretary needs to assure that the most pressing issues facing the Department receive sufficient attention, emerging issues are identified and dealt with, and programs are run efficiently and effectively. Our key recommendations dealt with the need for the Secretary to show strong support for effectively managing the Department by establishing a systematic Department-wide planning process, identifying priorities and measurable goals, and tracking progress systematically.

Secretary Brock generally agreed and acted quickly to implement reforms. In a follow-up assessment of the progress made by the Department, senior management officials believed that Secretary Brock's initiatives had significantly improved management. They hoped that the basic elements of the management system he established, such as secretarial involvement, goal-setting, and monitoring and feedback would remain in place, although they were concerned that they would not survive a change in administration. However, Secretary McLaughlin continued and expanded the management system started by Secretary Brock.

The Secretary should continue to use such a departmental management system.

Continue Development of Department-Wide Accounting System

Without well-managed accounting and internal control systems, the Secretary is vulnerable to accusations of inefficient implementation and management of departmental programs and activities. In our 1985 report we recommended several ways that Labor could strengthen its management and control over financial resources.

Many of the problems we identified have been corrected. Major financial reporting and other improvements, however, depend on the successful implementation of the ongoing Department-wide accounting system modernization program.

The Secretary should give high priority and allocate sufficient resources to completing the development of the central accounting system.

Enhancing Evaluation Activities

Because there is no comprehensive evaluation program at the secretarial level and few component agencies do systematic evaluations, the Department does not generally have evidence on whether its programs achieve their programmatic objectives. Perhaps the best example is OSHA, where our recent work showed significant shortcomings in OSHA's program for evaluating state-administered occupational safety and health programs. OSHA lacked information on how the states assure program quality and on the impact of state programs on worker safety and health. In fact, OSHA generally does little evaluation of federal compliance enforcement or other aspects of its programs.

Sustain Management Improvements

Evaluation can be a valuable management tool for making informed policy decisions, supporting the need for legislative changes, and controlling operations, as well as assisting in planning and budgeting.

The Secretary should establish a departmental evaluation program to assess the effectiveness of major programs so that policy and operational changes can be made when and where they are necessary.

Related GAO Products

Strong Leadership Needed to Improve Management at the Department of Labor (GAO/HRD-86-12, Oct. 21, 1985).

Department of Labor: Assessment of Management Improvement Efforts (GAO/HRD-87-27, Dec. 31, 1986).

Summer Youth Jobs Program: Congressional Action Has Increased Emphasis on Remedial Education (GAO/HRD-88-118, Sept. 30, 1988).

Job Training Partnership Act: Participants, Services, and Outcomes (GAO/T-HRD-88-31, Sept. 29, 1988).

Unemployment Insurance: Trust Fund Reserves Inadequate (GAO/HRD-88-55, Sept. 26, 1988).

"Sweatshops" in the U.S.: Opinions on Their Extent and Possible Enforcement Options (GAO/HRD-88-130BR, Aug. 30, 1988).

OSHA's Monitoring and Evaluation of State Programs (GAO/T-HRD-88-13, Apr. 20, 1988).

Plant Closings: Limited Advance Notice and Assistance Provided Dislocated Workers (GAO/HRD-87-105, July 17, 1987).

Job Training Partnership Act: Summer Youth Programs Increase Emphasis on Education (GAO/HRD-87-101BR, June 30, 1987).

Dislocated Workers: Exemplary Local Projects Under the Job Training Partnership Act (GAO/HRD-87-70BR, Apr. 8, 1987).

Dislocated Workers: Local Programs and Outcomes Under the Job Training Partnership Act (GAO/HRD-87-41, Mar. 5, 1987).

Emergency Jobs Act of 1983: Funds Spent Slowly, Few Jobs Created (GAO/HRD-87-1, Dec. 31, 1986).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

☆U.S. Government Printing Office: 1988-225-357:39418

United States General Accounting Office

GAO

Transition Series

November 1988

Housing and Urban Development Issues

GAO/OCG-89-22TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Secretary-designate of Housing and Urban
Development

This report is one of a series that summarizes major policy, management, and program issues facing agency heads in the new administration. Through our work in these areas, we have identified many concerns—some relatively new, others long-standing.

This report on the Department of Housing and Urban Development (HUD) describes our concerns about two important issues that need closer attention—low-income housing and homelessness. If these issues are not addressed, the Secretary of Housing and Urban Development can expect (1) continuing decreases in the supply of rental housing that is available and affordable to low-income people and (2) a growing national homelessness problem. In this report, we offer a wide range of observations and suggestions on how the Secretary of Housing and Urban Development can best address these concerns.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Giving Priority to the Availability and Affordability of Low-Income Housing 4

Solving the Homelessness Problem 11

Related GAO Products 13

Transition Series 14

Giving Priority to the Availability and Affordability of Low-Income Housing

The supply of rental housing that is available and affordable to low-income people is shrinking. Housing built with government subsidies in the 1960s is becoming eligible for sale or conversion to upscale condominiums and developments; public housing is deteriorating and underfunded; and tax incentives for encouraging private investment in low-income housing have been changed. At the same time, the demand for such housing is increasing, as a greater proportion of the nation's population falls below the poverty line. Two indicators suggest the magnitude of the problem:

- Over 24 million households have excessive rent burdens or live in crowded or substandard housing, as defined by HUD.
- Between 1975 and 1983, the population of very low-income rental households—those earning 50 percent or less of an area's median family income and thus least able to afford housing—increased from about 9.3 million to an estimated 12.2 million.

Retaining Private Low-Income Housing

HUD needs to encourage continued private investment in low-income housing, focusing on individual markets to determine the amount of additional federal incentives needed.

Over the next 15 years, over half of the 1.9 million privately owned and federally subsidized housing units available in fiscal year 1985 could be withdrawn from the low-income rental market, as restrictions limiting their use to low-income rental properties expire. This housing was financed in the 1960s with federal programs that provided below-market interest rate loans and mortgage insurance on riskier projects. In addition, substantial tax benefits were available to attract equity capital, and rental assistance contracts guaranteed a rental income equal to the fair market rent.

As federal subsidy and mortgage prepayment restrictions begin to expire, private owners of this low-income housing can choose to maintain it as a low-income housing resource or possibly find more advantageous alternatives. Recognizing this problem, the Congress included interim measures in the Housing and Community Development Act of 1987 to minimize losses from the federally assisted inventory. These measures include incentives to increase owners' rates of return, restraints on their voluntary prepayment of mortgages, and provisions supporting the purchase of projects by nonprofit or public agencies.

Because the current inventory of this housing is located in different housing markets, we cannot predict the amount of additional federal incentives necessary to retain private investment in this housing. Projects located in strong markets, which would support higher rents or alternative uses of property, have a high potential for being withdrawn from the inventory of low-income housing. To avoid loss of this housing, the government may have to offer owners very deep federal subsidies. Conversely, projects located in weaker markets may require little, if any, additional federal subsidy. Through further study of the potential loss of assisted housing in the various markets, the Congress and the President will be in a better position to decide what measures and how much federal spending should be devoted to this area.

Preserving Public Housing

HUD needs to consider the cost-effectiveness of preserving public, low-income housing.

Public housing—the nation's largest single source of low-income housing—is in serious disrepair, affecting living conditions of more than 1.3 million families. Although the federal government has spent about $8 billion in repair and modernization of this housing since 1975, backlogged work is expected to cost about $20 billion, according to HUD's 1987 study of the problem. Some of the larger urban public housing agencies, whose units may account for as much as 15 percent of the low-income rental stock in their locations, have the greatest needs. The Council of Large Public Housing Authorities has estimated that among the 35 largest agencies, approximately 140,000 family units are in such poor condition that they would require an average of $28,000 per unit to refurbish, for a total cost of $3.8 billion.

In addition to this immediate need, there is the long-range issue of whether and how to maintain the existing inventory of public housing projects, as these units experience normal physical deterioration and become obsolete over time. It is possible that meeting these additional needs alone could cost billions of dollars over the next 10 to 15 years.

Seeking Compatible Tax Policy

HUD should continually monitor, and attempt to influence, tax policy to ensure that it is achieving its goals of encouraging investment in low-income housing programs.

While the federally subsidized stock of rental housing is a vital resource for low-income families, the majority of these families live in unsubsidized, private housing. The loss of housing opportunities in this area depends on the environment for investing or reinvesting in rental housing versus other investment opportunities. This environment is heavily influenced by federal tax policies that can either complement or detract from other government housing policies and programs. As tax policy affecting the supply of low-income housing evolves over the next decade, HUD will continually need to coordinate its housing assistance programs with tax programs.

The Tax Reform Act of 1986 replaced a number of long-standing tax incentives for rental housing with a single tax credit to encourage new construction, rehabilitation, and preservation of low-income housing. Aware of the importance of the new tax credit both to national housing policy and to the specific housing programs it administers, HUD has initiated several studies to determine the credit's effectiveness.

In addition, tax legislation was introduced in the 100th Congress to facilitate the retention of low-income housing. Although this legislation has not been enacted, we believe that similar future legislation is needed to provide for improved coordination of tax policies with housing policies. This legislation should contain provisions that would strengthen (1) certain targeting provisions to ensure that housing projects provide the maximum possible assistance to low- and moderate-income households, consistent with the objectives of the direct housing assistance programs; (2) cost-control provisions aimed at maximizing the number of units assisted while minimizing costs; and (3) accountability and oversight by requiring a mechanism to evaluate the impact of tax policy on low-income housing.

Providing Benefits Through Both Vouchers and Certificates

Rather than continue separate housing voucher and certificate programs to assist low-income families, the Congress should consolidate the best features of both programs into one program aimed at providing equitable, cost-effective support to those with housing needs.

The voucher and certificate programs provide subsidies to low-income households to help them obtain decent, safe, and affordable rental housing on the private market. Although their goals are the same, the costs and benefits of these two programs differ. By reconciling these differences, the Congress could create a unified demand-based subsidy that would equalize benefits to low-income households.

Under both vouchers and certificates, public housing authorities pay rent subsidies directly to landlords on behalf of low-income tenants. However, vouchers are more costly than certificates, principally because the vouchers' subsidies are based on HUD-established rent standards. In contrast, certificates' subsidies are based on actual rents that families pay, up to the same rent standard. Vouchers provide higher subsidies than certificates when families rent units for less than the HUD-established rent standards. Because of this difference, vouchers are able to assist fewer low-income households than certificates, given the same budget allocation.

Using actual cost information from HUD's voucher demonstration program, we project that HUD's $3 billion budget request (fiscal year 1989) for the voucher program could serve 9,500 fewer (6 percent less) households than could be aided by certificates. An additional $208 million would be needed if the voucher program were to serve the same number of households as the certificate program.

Solving the Homelessness Problem

While the McKinney Act addresses the immediate needs of the homeless, long-term solutions are needed that take into account the diversity of the homeless population and the array of contributory causes.

As many as 3 million people in the United States may be homeless, and most studies agree that the number is growing rapidly, especially among families with children. Many of the homeless, often single women with children, cannot find affordable housing. Many others are homeless because of substance abuse or mental illness. There is little agreement as to how many people comprise each homeless category.

To address the problems of the homeless, the Congress enacted the Stewart B. McKinney Homeless Assistance Act, authorizing a number of federal programs primarily directed at alleviating the immediate needs of the homeless. Authorized funding is about $500 million annually; HUD receives the bulk of these funds.

Although the McKinney Act formally recognizes the homelessness problem as a national issue and provides funds to alleviate the immediate needs of the homeless, it does not provide long-term solutions or comprehensive approaches. Homeless people are sociologically and economically diverse and often need support services—education, job training, or psychological and drug counseling—as well as housing. Given this complex problem, HUD needs to provide leadership in identifying the types of federal initiatives that would be successful. Such initiatives need to be based on thorough analyses of the population being served and analyses of the effectiveness of federal, state, local, and private programs that are assisting the homeless.

The McKinney Act required GAO to issue status reports in 1987 and 1988 regarding the use of the act's appropriated funds. Our 1987 report found that HUD and the Federal Emergency Management Agency experienced difficulties in meeting legislated milestones for disbursing funds and publishing program regulations. We anticipate continuing congressional interest as concerns grow about the extent and causes of homelessness.

Related GAO Products

Giving Priority to the Availability and Affordability of Low-Income Housing

Rental Housing: Potential Reduction in the Privately Owned and Federally Assisted Inventory (GAO/RCED-86-176FS, June 16, 1986).

Role of Tax Policy in Preserving the Stock of Low-Income Rental Housing (GAO/T-RCED-88-22, Mar. 3, 1988).

Housing Programs: Funding Approach for HUD's Section 8 Certificate Program Needs Changing (GAO/RCED-88-136, Apr. 18, 1988).

Rural Rental Housing: Impact of Section 515 Loan Prepayments on Tenants and Housing Availability (GAO/RCED-88-15BR, Feb. 11, 1988).

Solving the Homelessness Problem

Homelessness: Implementation of Food and Shelter Programs Under the McKinney Act (GAO/RCED-88-63, Dec. 8, 1987).

Homeless Mentally Ill: Problems and Options in Estimating Numbers and Trends (GAO/PEMD-88-24, Aug. 3, 1988).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

☆U.S. Government Printing Office: 1988-225-357:39418

United States General Accounting Office

GAO

Transition Series

November 1988

Foreign Economic Assistance Issues

GAO/OCG-89-23TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Administrator-designate, Agency for
International Development

This summary report is one in a series addressing major policy, management, and program issues facing Congress and the new administration. Discussed in this report are key issues relating to the foreign economic assistance programs of the Agency for International Development (AID).

Three broad categories of issues are addressed: (1) reexamining AID's role in critical policy areas, (2) improving AID management and administration, and (3) strengthening accountability and control over assistance. Because the bilateral assistance program represents such an important link between the United States and the developing world, we believe that these issues need to be considered in efforts to design an effective program for the 1990s.

These issues are discussed in detail in the documents and reports listed at the end of this report.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Role of the Agency for International Development in Critical Policy Areas 4

Managing the AID Program 7

Strengthening Accountability and Control Over Funds 10

Related GAO Products 12

Transition Series 14

Role of the Agency for International Development in Critical Policy Areas

For over a quarter of a century, the United States has provided billions of dollars in bilateral economic assistance to the developing world. The program has made important contributions to improving conditions in developing countries; however, there is increased concern that the Agency for International Development (AID) is not able to manage the program effectively.

In the early 1970s, the emphasis of U.S. development assistance changed from large infrastructure projects (e.g., dams, roads, buildings, and industrial plants) to activities designed to directly address the basic needs of the poor. AID officials believe this emphasis encouraged AID to reorient its strategy toward numerous small-scale projects, which were more complex to design and created management burdens, less visibility for the United States, less potential for policy leverage with recipient governments, higher administrative costs, and reduced capacity to meet political and/or development objectives. A rethinking of this basic strategy may be necessary.

The Foreign Assistance Act of 1961, as amended, now contains more than 30 separate directives covering a wide range of development assistance objectives, such as promoting human rights, protecting tropical forests, integrating women into the economies of developing countries, and using appropriate technology for small farms and businesses.

Each directive has merit, but the multiplicity of objectives

- creates confusion as to the direction the Congress believes the foreign assistance program should take,
- contributes to a lack of consensus between the Congress and the executive branch on the priorities of programs, and
- reduces the possibility of AID being held accountable for achieving any particular objective.

In reexamining the legislative framework, the Congress and the administration need to consider the policies and priorities AID should be addressing in the 1990s. In addition, consideration should be given to identifying better ways to administer, manage, and control resources allocated to the program.

Among the many development issues confronting the program, the administration and the Congress need to examine the role of AID in addressing the multidimensional issues of international debt, narcotics control, environmental degradation, and Acquired Immune Deficiency Syndrome. For example, during 1987 developing countries experienced a $29-billion net outflow, largely due to the interest they paid on their $1.2-trillion external debt.

The magnitude of the debt problem raises several questions concerning the amount of foreign aid that may be necessary to help encourage economic growth in developing countries, the extent to which the United States can or should intervene in the international debt problems of developing countries, and the aid strategy that is most appropriate for individual countries.

Managing the AID Program

Audits and evaluations have repeatedly identified significant and recurring management weaknesses in AID, raising questions as to whether it has exceeded its capacity to manage a program consisting of approximately 2,000 projects in more than 70 countries throughout the developing world. Although decentralized operations are critical to achieving AID's goals and an asset in conducting U.S. foreign policy, such operations clearly increase the complexity of programming, make management and oversight more difficult, contribute to increased administrative and program costs, and increase the risk of fraud and abuse.

To manage its worldwide activities, AID has had to place increasing reliance on contractors and host-country nationals. This has led to monitoring weaknesses and has directly contributed to problems in accountability and control over funds which reduce the effectiveness of our assistance programs.

Also, a basic tenet of the AID program is to encourage sustained economic growth. However, recipient governments have repeatedly failed to provide agreed upon counterpart funding for project assistance, thus delaying project implementation, increasing U.S. costs, and reducing program impact. Similarly, after AID's involvement has ended, completed projects have become unproductive or have not achieved their full potential, due to insufficient cost financing and poor operations and maintenance by the recipient.

AID needs to consider focusing programs on more manageable units by reducing the number of overseas missions, concentrating resources and personnel on key countries, and concentrating resources on fewer and/or larger projects rather than on numerous small projects.

AID also needs to use program funds more efficiently and in a more timely manner. AID's multi-billion dollar pipeline of obligated but undisbursed funds suggests inefficient use of available funding and program/project implementation difficulties. AID should reduce the pipeline by such methods as requiring that obligations on the books for long periods of time be systematically reviewed and revalidated.

AID generates several hundred reprogramming notifications annually, representing over $1 billion in revised budget allocations. Under current legislation, AID must justify to Congress most changes it proposes to make to the program outlined in its annual budget. Improvements in programming should lead to reducing the number of reprogramming notifications and thus reduce AID's administrative burden.

Strengthening Accountability and Control Over Funds

The credibility of the AID program has been weakened by accusations and revelations about misuse and diversions of funds. Control over Economic Support Fund (ESF) programs, which grew from $1.9 billion in fiscal year 1979 to $3.9 billion in fiscal year 1987, has been questioned. According to an internal AID analysis, U.S. dollars have gone to Swiss or other offshore bank accounts. Also, the disposition or use of ESF cash transfer dollars often could not be determined because the funds were commingled with other recipient country revenues and host-country reporting frequently was inaccurate, late, or non-existent. AID has made efforts to improve accountability and control over ESF programs, but it needs to strengthen control over program funds.

AID also needs to improve its control over local currencies generated from the Commodity Import and Public Law 480 Programs. Because of inadequate accounting, monitoring, and reporting, AID cannot systematically determine whether required deposits were made or whether withdrawals and disbursements were made for agreed purposes. AID could significantly improve its management of local currencies by upgrading accountability and control requirements, strengthening monitoring of fund use, and independently verifying reports by host-countries on uses of local currencies. Accomplishing this will require strong executive branch and congressional support.

Many of AID's accountability problems can be traced to limitations and weaknesses of recipient countries. Most developing countries agree that improved financial management capability could significantly benefit the performance of U.S. development assistance programs. AID should include strengthening the financial management capabilities of AID recipients as an integral part of its long-term assistance strategy.

Related GAO Products

FOREIGN AID: Better Management of Commodity Import Programs Could Improve Development Impact (GAO/NSIAD-88-209, Sept. 26, 1988).

FOREIGN AID: Improving the Impact and Control of Economic Support Funds (GAO/NSIAD-88-182, June 29, 1988).

DRUG CONTROL: U.S. International Narcotics Control Activities (GAO/NSIAD-88-114, Mar. 1, 1988).

FOOD AID: Integration With Economic Assistance Programs in Four African Countries (GAO/NSIAD-88-96FS, Feb. 25, 1988).

FOOD AID: Improving Economic and Market Development Impact in African Countries (GAO/NSIAD-88-55, Dec. 21, 1987).

AIDS: Information On Global Dimensions and Possible Impacts (GAO/NSIAD-88-51FS, Oct. 28, 1987).

LIBERIA: Need To Improve Accountability and Control Over U.S. Assistance (GAO/NSIAD-87-173, July 16, 1987).

FOREIGN AID: Potential for Diversion of Economic Support Funds to Unauthorized Use (GAO/NSIAD-87-70, Jan. 14, 1987).

FOREIGN ASSISTANCE: U.S. Use of Conditions to Achieve Economic Reforms (GAO/NSIAD-86-157, Aug. 25, 1986).

FOREIGN ASSISTANCE: How the Funds Are Spent (GAO/NSIAD-86-73, Mar. 7, 1986).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

☆U.S. Government Printing Office: 1988-225-357 39418

United States General Accounting Office

GAO Transition Series

November 1988

Interior Issues

GAO/OCG-89-24TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Secretary-designate of the Interior

This report is one of a series that summarizes major policy, management, and program issues facing agency heads in the new administration. Through our work in these areas, we have identified many concerns—some relatively new, others long-standing.

This report on the Department of the Interior summarizes several issues concerning Interior's stewardship and fiduciary responsibilities. It describes our concerns about the need to (1) balance better the competing demands on and increase funding for natural and cultural resources and (2) provide assurances that revenues due the government are being collected. We also offer a wide range of observations and suggestions on how the Secretary of the Interior can best address these concerns.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1
Balancing Competing Demands on Natural and Cultural Resources 4
Meeting Program Goals and Objectives 10
Fulfilling Fiduciary Responsibilities 13
Related GAO Products 20
Transition Series 22

Balancing Competing Demands on Natural and Cultural Resources

The Department of the Interior is the principal steward of over 500 million acres, which represent about a fourth of the nation's lands and waters. Interior's stewardship responsibilities include protecting fish and wildlife, preserving environmental and cultural values, improving the quality of life through outdoor recreation, and ensuring the orderly development of mineral resources.

Interior must assume a more effective stewardship role by better balancing competing demands on the natural and cultural resources it is legislatively mandated to foster, protect, and preserve. In some instances, Interior has been more concerned with either the immediate needs of special interest groups or budget reductions than with ensuring the long-term viability of the resources.

Overuse and Other Factors Are Threatening National Parks

Interior must develop a systematic, comprehensive approach to protect and manage park resources.

National parks contain many of the most valuable and treasured historic, cultural, natural, and scenic resources the nation has to offer. They are, however, threatened both from within and outside their boundaries. Interior's park managers told us that the deterioration of some assets, including roads, trails, public buildings, equipment, and utility systems, is so advanced that, if not repaired or maintained soon, they may be lost permanently.

Continuing problems threatening the parks include

- overuse by park visitors and
- detrimental activities or sources located outside of the parks, including aesthetic degradation from land development and timbering, air pollution caused by acid rain or hydrocarbon pollutants, and water quality changes and pollution caused by such things as oil spills and toxic chemicals.

Compounding Interior's problem, projects intended to mitigate deteriorating resources and threats to health and safety have not been funded; for example, none of the nearly 100 projects proposed in fiscal year 1986 to document or mitigate threats in 10 parks were funded. Further, Interior does not have comprehensive resource management plans for some of the national parks to monitor and manage existing resources, specify staffing and funding needs, or rank problem areas.

Overgrazing Is Damaging Public Rangelands

Interior must take aggressive steps to assess the carrying capacity of public rangelands, establish appropriate grazing levels, and restore grazing-damaged riparian areas.

Livestock overgrazing is damaging a large portion of the public's land. Despite various congressional initiatives, over half of the public rangelands remain in only fair or poor condition, and about one out of every five public rangeland grazing allotments is threatened with further deterioration. The condition of riparian areas—those ecologically critical zones bordering rivers, streams, lakes, and bogs—is even worse. Tens of thousands of miles of streams have degraded riparian areas needing improvement.

The primary cause of this degradation is poorly managed livestock grazing. (When more livestock are allowed to graze in an area than the land can support, forage consumption exceeds the regenerative capacity of the natural vegetation, resulting in erosion, watershed damage, and other deterioration.) Interior field staff we surveyed stated that the Department seems more concerned with meeting the immediate needs of livestock ranchers than with ensuring the long-term viability of the lands.

Interior can better manage public rangelands by

- implementing changes to focus attention on grazing allotments that are overstocked and/or declining, including conducting the assessments needed to establish appropriate grazing levels, and
- establishing finite goals for restoring riparian areas, annually measuring the progress made toward achieving those goals, and justifying instances where proposed restoration efforts are seriously thwarted.

Hardrock Mining Policy Is Damaging Public Lands

Interior should require all mine operators to post a bond or financial guarantee to ensure reclamation of federal lands if the operations cause significant land disturbance.

Despite evidence of the damage to public lands caused by mining for "hardrock" minerals, such as gold, copper, silver, lead, and iron, Interior has not required most mine operators to post a bond or financial guarantee in the event that the operations result in a need for reclamation, such as reshaping the land, reapplying topsoil and vegetation, and removing or controlling toxic materials. In contrast, the U.S.

Department of Agriculture requires financial guarantees from all miners on its national forest lands whose operations are likely to cause significant disturbance. This requirement appears to have minimized the amount of unreclaimed land and has provided Agriculture with the funds needed for reclamation.

Interior bonds mine operators only if the operators have a record of noncompliance, and it does not require bonds for other operators working under notices of intent, the most frequent type of mining operation. Interior told us that these procedures are adequate. However, we have found that there are over 280,000 acres of abandoned, suspended, or unauthorized mining operations on federal lands in 11 western states. Reclaiming these lands will cost an estimated $284 million, and an additional 140,000 acres of federal land currently being mined will also eventually need to be reclaimed.

Interior Lacks Vigorous Oversight of Surface Mining

Interior must put more teeth into enforcement of environmental standards relating to surface mining.

The Surface Mining Control and Reclamation Act of 1977 provides Interior an assortment of enforcement tools to help ensure mine operator compliance with various environmental protection standards. Although most coal-mining states have been granted authority for regulating coal-mining operations within their borders, Interior retains responsibility for ensuring that states are effectively implementing the provisions of the act.

Interior and the states have had mixed success in carrying out their regulatory responsibilities. While some progress has been made in forcing compliance, many violations have gone undetected, few monetary penalties have been assessed and collected, and many of the enforcement tools outlined in the act have not been exercised to the fullest extent. As a result, lawsuits have been filed challenging the vigor with which mining standards are being enforced, while congressional committees question Interior's regulatory commitment.

Meeting Program Goals and Objectives

For a variety of reasons, including budget considerations and new program requirements, Interior has proposed reducing federal funding for many natural and cultural resource programs and activities. At the same time, we believe that billions of dollars are needed to accomplish the goals and objectives envisioned in enabling legislation. Without adequate funding, deterioration of, and possible irreversible damage to, natural and cultural resources will continue.

Cost of Deferred Park Maintenance Is Approaching $2 Billion

Adequate funding is needed to prevent growth of the backlog of deferred park maintenance and further deterioration of park assets.

In 1987, we were told by 267 park unit managers that there was a $1.9 billion cumulative shortfall in park maintenance funding and a need for 35 percent more maintenance staff. Most of the shortfall—about $1.4 billion, or 74 percent of the total—was reported by 20 park unit managers. Included in the $1.9 billion shortfall was $1.6 billion in capital improvements, approximately 56 percent for road repair projects, and 44 percent for general construction of park facilities.

As a result of maintenance deferrals, assets have deteriorated. We found that deterioration ranged from unmowed grass and peeling paint to collapsed structures and closed hiking trails.

About $3 Billion More Will Be Needed to Reclaim High-Priority Abandoned Coal Mines

To help reclaim abandoned mine sites, legislation is needed to extend fee collections beyond 1992.

In 1977, the Congress established a fund to reclaim lands around surface coal mines abandoned before 1977; the fund is primarily supported through the collection of reclamation fees from ongoing mining operations. When fee collections statutorily end in 1992, mine operators will have deposited an estimated $3 billion into the fund. However, this funding level will fall short of the estimated $6 billion needed to correct high-priority problems affecting public health and safety. An estimated $33 billion is needed to address all land problems at abandoned mines.

Archeological Surveys Will Cost Billions of Dollars

Increased funding is required if more irreplaceable cultural artifacts on public lands are to be identified and protected.

Federal agencies are required by legislation and executive order to locate and inventory all significant archeological sites on their lands. In December 1987 we reported on federal agency efforts to protect and preserve a wealth of archeological resources located on public lands in Arizona, Colorado, New Mexico, and Utah, concluding that

- federal agencies had identified and recorded only about 7 percent of the archeological sites thought to be on federal lands and
- funding and staffing constraints, together with the vastness of the area's federal lands, have limited the agencies' physical protection to only a small portion of the known sites; as a result, they have been unable to curb the looting and destruction of identified antiquities.

Surveying all of the remaining agency lands in the four states would be costly—between $400 million and $2 billion. And, Interior estimates that it would cost over $14 billion ($566 million annually for 25 years) to complete nationwide surveys of all park lands.

Fulfilling Fiduciary Responsibilities

Interior's oil and gas leasing, other mineral leasing activities, and rangeland programs are expected to generate revenues of about $5 billion in fiscal year 1989. These resources represent a valuable national asset, and the revenues they generate accrue to the U.S. Treasury, the states, and Native American tribes. We have found that Interior has not always collected the revenues due the government or taken advantage of opportunities to increase future revenues. Therefore, it has not always fulfilled its fiduciary responsibilities.

Collection of Mineral Royalties Is Uncertain

Interior needs to assure that mineral royalty collections are complete and accurate.

Interior's administrative deficiencies have caused the government to lose hundreds of millions of dollars in oil, gas, and coal royalties and rent. These deficiencies include not readjusting royalty rates on federal coal leases by their anniversary date as provided by statute and not increasing certain oil and gas lease rents in a timely manner.

Although Interior has acted on many recommendations, it still cannot provide adequate assurances that it is collecting most royalties due the government. For example, in April 1988, Interior's Inspector General reported that Interior's audit coverage of royalty payors was inadequate, in part because Interior's auditors had performed comprehensive audits of less than 2 percent of the onshore federal oil and gas leases in fiscal years 1986 and 1987.

Proposed Alaska Land Exchanges Are Not in the Government's Best Interest

Interior should discontinue consideration of proposed Alaska land exchanges because they are not in the best interest of either the government or the wildlife they are intended to protect.

In proposed land exchanges between Interior and six groups of Alaska Native corporations, the Native groups would receive potentially lucrative oil and gas rights in the Arctic National Wildlife Refuge in exchange for lands they now own within the boundaries of other wildlife refuges in Alaska. However,

- Interior did not employ generally accepted methods for dealing with the uncertainty associated with oil and gas prospects on these lands, even though it has stated that the oil and gas leases have been rated by geologists as the nation's best single opportunity to increase domestic oil production over the next 40 years;

- the negotiated price the government would pay for the lands owned by the Native groups is six times their appraised fair market value; and

- much of the lands to be acquired would provide limited additional wildlife and habitat protection benefits.

Although the federal government frequently enters into land exchanges, it normally does not trade away oil and gas rights on public lands. As a result, there are few precedents to use to determine the actions that should be taken to protect the public's interest. The closest parallel is the government's program for oil and gas lease sales.

In lease sales, the government allows the marketplace to value the oil and gas tracts through competitive bidding. Under the proposed land exchanges, however, Interior did not require the Native corporations to competitively bid against each other for the tracts. The government also usually retains a continuing ownership interest in any future oil production through a royalty provision. In doing so, the government is willing to share the risk with the developer by accepting a smaller payment up front and potentially receiving no royalties in exchange for what it hopes will be a greater return through royalties in the event of a large find. Under the proposed land exchanges, however, Interior does not retain a continuing royalty interest in any future oil production, even though there are indications that the lands may be exceptionally favorable for discovery of one or more supergiant fields (larger than 500 million barrels).

Moreover, Interior appraised the fair market value of the proposed acquisitions at $90 million but arrived at a negotiated price of $539 million, a six-fold increase, concluding that the fair market value did not take into account their true environmental or public interest value. In negotiating the exchange price, Interior used some inappropriate comparisons of prices from previous land transactions. For example, two of the comparisons involved lands in other states where land values are generally higher.

Finally, 76 percent of the lands that the government would acquire under the proposed exchanges

- have been rated by Interior as low priority or unsuitable for acquisition,

- are already protected by law from uses that are inconsistent with wildlife refuge purposes, or
- are most threatened by subsurface mineral development, although Interior would not acquire the subsurface rights under the terms of the proposed exchanges.

Interior is prohibited by law from conveying interests in lands within the Arctic National Wildlife Refuge without prior approval by act of Congress. We have recommended that if Interior decides to proceed with the proposed exchanges and presents them to the Congress for approval, the Congress should disapprove them.

Water Subsidies Continue to Flow to Large Farms

If federally subsidized water is to be limited to separately operated farms, then clarification of congressional intent relating to a 960-acre limitation may be required.

In 1982, the Congress established a 960-acre limit for farms receiving federally subsidized irrigation water. Federal water delivered to acreage that exceeds this limit is to be assessed at a significantly higher rate.

In the past several years, some farms that exceed the legislatively established limit have been divided into landholdings of 960 acres or less. These landholdings continue to be operated collectively as one large farm, but they qualify individually for subsidized water under Interior's regulations. For example, our work identified one 12,000-acre farm that was divided into 15 separate landholdings, all but 1 of less than 960 acres. The 15 landholdings, however, continue to be operated as one large farm. This reorganization has allowed the farm to continue to receive subsidized water on most of the 12,000 acres, and it reduced by about $500,000 the cost of the water received in 1987.

The law and legislative history are silent on these types of arrangements. In our view, however, reorganizations that permit large farms to maximize federal water subsidies, thus reducing federal revenues, are not consistent with what we believe the Congress was trying to accomplish in establishing the 960-acre limit.

Valuable Lands Are Being Sold at Nominal Amounts

Miners should not be given title to the land that they are mining.

In general, the law calls for the federal government to obtain fair market value for the resources it controls. Interior, however, continues to sell valuable federal lands for a nominal amount—$2.50 or $5.00 an acre—under a patent provision of the Mining Law of 1872. Although the legislation is intended to give miners title to the land that they are mining, some lands acquired in this manner have such substantial value that they have been resold at a handsome profit or used for nonmineral purposes.

Public and congressional interest in the patent provision was rekindled in 1986 when Interior sold under patent 17,000 acres of oil shale land for which the government received $42,500. Weeks later, the patent holders sold this land to a major oil company for $34 million. We have found numerous other instances, in such places as the Phoenix and Las Vegas areas and the ski country of Colorado, where Interior sold land, under the patenting provision, for far less than its fair market value and in the process lost millions of dollars in potential revenue.

Related GAO Products

Parks, Recreation, and Cultural Resources	Parks and Recreation: Park Service Managers Report Shortfalls in Maintenance Funding (GAO/RCED-88-91BR, Mar. 21, 1988).
	Parks and Recreation: Limited Progress Made in Documenting and Mitigating Threats to the Parks (GAO/RCED-87-36, Feb. 9, 1987).
	Cultural Resources: Problems Protecting and Preserving Federal Archeological Resources (GAO/RCED-88-3, Dec. 15, 1987).
Federal Land Ownership	Federal Land Management: Consideration of Proposed Alaska Land Exchanges Should be Discontinued (GAO/RCED-88-179, Sept. 29, 1988).
	Rangeland Management: More Emphasis Needed on Declining and Overstocked Grazing Allotments (GAO/RCED-88-80, June 10, 1988).
	Public Rangelands: Some Riparian Areas Restored But Widespread Improvement Will Be Slow (GAO/RCED-88-105, June 30, 1988).
Federal Mineral Resources	Federal Land Management: Limited Action Taken to Reclaim Hardrock Mine Sites (GAO/RCED-88-21, Oct. 21, 1987).

Federal Land Management: Financial Guarantees Encourage Reclamation of National Forest System Lands (GAO/RCED-87-157, Aug. 24, 1987).

Mineral Revenues: Coal Lease Readjustment Problems Remedied but Not All Revenue Is Collected (GAO/RCED-87-164, Aug. 25, 1987).

Surface Mining Controls

Surface Mining: State and Federal Use of Alternative Enforcement Techniques (GAO/RCED-87-160, Aug. 20, 1987).

Surface Mining: States Not Assessing and Collecting Monetary Penalties (GAO/RCED-87-129, June 5, 1987).

Surface Mining: Transferring Interior's Surface Mining Regulatory Function (GAO/RCED-88-161, June 9, 1988).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

☆U.S. Government Printing Office: 1988-225-357:29418

United States General Accounting Office

GAO

Transition Series

November 1988

Transportation Issues

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Secretary-designate of Transportation

This report is one of a series that summarizes major policy, management, and program issues facing agency heads in the new administration. Through our work in these areas, we have identified many concerns—some relatively new, others long-standing.

This report, on the Department of Transportation, describes our concerns about (1) meeting transportation challenges through strong secretarial leadership, (2) revising the plan to modernize the air traffic control system, (3) improving the Federal Aviation Administration's effectiveness, (4) improving management of transportation infrastructure, and (5) reassessing the Coast Guard's role. We also offer a wide range of observations and suggestions on how the Secretary of Transportation can best address these concerns.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Meeting Transportation Challenges Through Strong Secretarial Leadership 4

Revising the Plan to Modernize the Air Traffic Control System 9

Improving FAA's Effectiveness, Whether or Not It Is Independent 13

Improving Management of Transportation Infrastructure 19

Reassessing the Coast Guard's Role 25

Related GAO Products 29

Transition Series 31

Meeting Transportation Challenges Through Strong Secretarial Leadership

Transportation is vitally important to the nation's economy, accounting for 15 percent of national employment and 25 percent of the cost of the goods we buy. Currently, the Department must address the aging of much of the nation's transportation infrastructure, rapid growth in demand (with attendant congestion and costly delays), mounting concern for preserving and enhancing safety, and severe fiscal constraints imposed by accumulated federal deficits. Now, more than ever before, there is a need for integrated national transportation planning to ensure sound investments of scarce resources and a safe, effectively organized, and efficiently operating multimodal system. To successfully meet these challenges, the Secretary must take the lead in formulating a coherent national transportation plan.

Enhancing Secretarial Leadership in Policy-Making and Program Oversight

The Department needs to continue efforts to (1) develop and adopt agencywide tools for policy decision-making and (2) devise and use early warning indicators of safety risk and measures of program performance.

The challenges facing the Department call for strong secretarial leadership in policy development, including articulating a coherent vision of the nation's transportation system and formulating an integrated set of policies and plans to achieve that vision. They also call for building and strengthening the organizational capacity and means through which the Secretary can provide the direction needed to ensure effective implementation of policies and plans. The Secretary also has an important role to play in strengthening departmental management by identifying opportunities to enhance program effectiveness and applying insights and lessons learned from the evaluation of one program to the management of programs in other modes.

Transportation safety is one area where national transportation planning and management improvement should be—and to some extent already have been—carried out at the secretarial level. For example, secretarially directed "white glove" inspections and safety task force reviews were carried out in 1984-85 on the Federal Aviation Administration's (FAA) air carrier safety inspection and security screening programs. They illustrate how such reviews might be used to improve measures of program performance, increase efficiency in staff use, and target limited resources to areas of greatest need and potential payoff. Our examination of the safety task force reports—as well as our own safety program assessments in the Coast Guard, Federal Highway Administration, and Federal Railroad Administration—suggests that secretarial-level oversight and evaluation could provide both the basis and the impetus for developing

- early warning indicators of safety risks and modal performance problems that could be used to identify and remedy unsafe conditions before accidents occur;[1]
- techniques for targeting inspection resources on the basis of identified high-risk conditions;
- productivity improvement initiatives employing standards/goals of quality, timeliness, and efficiency to promote effective and efficient use of resources and accountability for results; and
- techniques for determining resource needs and assessing progress in meeting program goals.

Consistent with recommendations we made in 1987, the Department has taken an important initial step toward institutionalizing the capacity to achieve these kinds of improvements by creating an Office of Safety Program Review, headed by a Deputy Assistant Secretary for Safety. While there have been delays in staffing this office, it has the potential to serve as a good vehicle for exercising secretarial oversight and direction and strengthening safety policies and programs agencywide. A comparable entity, devoted to other crosscutting policy and planning issues, could, in the same way, provide a vehicle for secretarial leadership in integrated national transportation planning.

---

[1] The Congress recently directed that such indicators be developed in the aviation area. They should also be developed for rail, highways, pipelines, and marine transportation.

Reductions in Transportation Data Have Hampered the Department

The Department needs to inventory its data requirements and identify the most cost-effective ways of satisfying them.

The Secretary's ability to formulate sound policies and oversee their implementation depends on the availability of an adequate base of information regarding the condition and operation of the transportation sector and the results of existing policies and programs. Yet, the amount and types of policy analytic data collected by the Department have been reduced in recent years, primarily for reasons of economy and a desire to reduce the reporting burden on the private sector.

Such reductions have resulted in a diminished ability to monitor the performance of the transportation sector and to accurately assess the consequences of policy decisions. For example, we have reported that data limitations relating to aviation hampered the Department in

- recognizing the potential effects on safety of airline deregulation and growth, and
- assessing the impact on consumer fares of airline mergers.

These examples illustrate how timely and accurate information is indispensable to the successful exercise of the Department's roles and responsibilities.

Revising the Plan to Modernize the Air Traffic Control System

Six years into modernization of the air traffic control (ATC) system, FAA is finding that many key projects are taking longer than expected and that additional equipment is needed to meet operational requirements. Furthermore, FAA has experienced delays in installing equipment in the field due to inadequate planning and insufficient staff. Because modernization is vital to maintaining a safe and efficient ATC system, we believe that FAA should revise its modernization plan to

- identify all ATC modernization projects and associated costs;
- establish realistic schedules reflective of past experience; and
- include in project cost and schedules the number of technicians needed to install, operate, and maintain the new equipment.

Plan Does Not Identify All Modernization Projects and Costs

Issued in 1981, the National Airspace System (NAS) Plan called for a technologically complex overhaul of the ATC system, including new surveillance and weather radars, computers, and communications systems. The plan was initially envisioned as a comprehensive identification of all ATC capital improvements needed by FAA until the year 2000. In turn, on the basis of the plan's cost and schedule, legislation was passed to ensure financing by the Airport and Airway Trust Fund. Specific revenue sources—such as an 8-percent tax on passenger tickets—were instituted.

Today, the NAS Plan no longer represents the full extent of modernization. While some new projects have been incorporated in the plan, many ATC modernization projects have not. These projects include those that enable interdependent systems to function correctly, as well as shorter-term solutions such as upgrading terminal area computers. Furthermore, because no project costs are provided in the NAS Plan, the full cost of ATC modernization cannot be assessed by those responsible for making funding decisions. Consequently, the adequacy of Trust Fund revenues to finance continued modernization cannot readily be determined.

Projected in 1983 at about $12 billion, the NAS Plan is now estimated by FAA to cost about $16 billion. However, because the scope of modernization has gone beyond the NAS Plan, we found that actual ATC modernization could cost about $25 billion by the year 2000.

Schedules Should Reflect Past Experience

More than half of the NAS Plan budget is for 12 projects designated as major systems—projects that will cost more than $150 million each or are critical components of the plan. The 12 major systems have experienced schedule delays ranging from 1 to 5 years. FAA underestimated the complexity of these systems, the time needed to develop software, and the interdependency among systems. Some technologies, thought to be available "off-the-shelf," required further development and testing to meet operational requirements. Project delays have had detrimental effects. First, although FAA expects ultimately to provide better air traffic control with fewer staff because of NAS Plan improvements, the delays are making it difficult for FAA to provide the level of air traffic control needed in the meantime. Second, the NAS Plan is intended to save the airline industry considerable expense by reducing delays and permitting more effective routing, but these benefits are now being pushed further into the future.

Planning Shortfalls and Inadequate Installation Staff Could Delay Modernization

FAA is reaching another critical phase in its modernization effort as an increasing number of NAS Plan systems are being delivered to the field. While the delays described above were encountered during project development, FAA is now encountering more problems and delays in implementing systems in the field. In some cases, these problems have occurred because FAA did not plan sufficiently to know what had to be done to get facilities ready or did not have enough staff to install the equipment.

FAA plans to address regional staffing problems in implementing NAS systems through a recently awarded contract for technical support services. However, we found that the original request for proposals for such services provided for about 2,000 fewer staff years than FAA's resource estimating system indicated would be necessary. Unless sufficient resources are applied to meet the current NAS Plan schedule, the schedule must be extended and could further increase the cost of ATC modernization.

Improving FAA's Effectiveness, Whether or Not It Is Independent

Several proposals have been advanced that would remove FAA from departmental oversight. The proposals would provide FAA with more autonomy in meeting the challenges of a growing aviation industry and, in the process, exempt the agency from procurement and personnel regulations normally applicable to federal agencies. We examined the reasons offered to support establishing an independent FAA and found that independence would solve neither the agency's procurement nor its personnel problems; nor would independence in itself be sufficient to meet the challenges of rebuilding the air traffic control system and funding FAA operations. Instead, a number of actions will be needed to enhance FAA's effectiveness, regardless of the agency's organizational placement.

Adherence to Procurement Rules Did Not Cause Major Delays

FAA should adopt a more prudent major system acquisition process that minimizes risks by including sufficient time for properly designing and operationally testing costly and complex systems.

We found that following procurement regulations was not the primary cause for FAA's acquisition difficulties in developing NAS Plan systems. Rather, FAA's acquisition problems often stem from the agency's large-scale procurement inexperience, leading to inadequate planning and underestimates of the time needed to develop complex technology. This has resulted in significantly extending the schedules of many NAS Plan systems.

FAA has only selectively followed the Office of Management and Budget's recommended approach for developing complex systems, and consequently, FAA has not had a sufficient basis to approve systems for production. For example, we found that production of the $1.6 billion microwave landing system was begun before the number and location of sites were validated, benefits demonstrated, and a system prototype tested in an operational environment. We believe that this testing is important because it can alert FAA to the problems a production contractor might have later and thus avoid significant delays in fielding the system.

Fundamental Personnel Problems Remain to Be Resolved

FAA needs reliable staffing estimates to help restore congressional confidence in its judgments about personnel requirements. FAA also needs a national recruitment strategy that uses innovative approaches to attract and retain high-caliber employees.

FAA faces a number of personnel problems that must be addressed regardless of whether it becomes an independent agency. Chief among these problems is that it does not know how many people are or will be needed to carry out its mission. We found that FAA had underestimated its staffing requirements for three critical work forces—air traffic controllers, aviation safety inspectors, and maintenance technicians. Without reliable staffing standards—a critical management tool for determining work force requirements—FAA has not been able to ensure that its budget requests reflect actual needs and, as a result, the Congress has approved funding levels that differ from those requested.

FAA does not have a recruitment policy or a coordinated recruitment program and is finding it difficult to attract and retain high-quality personnel. While FAA has taken some actions on a national level, such as initiating a streamlined controller hiring process, it is critical that the agency develop a national recruitment strategy rather than relying on regions to recruit as needed. FAA could also do more to attract personnel to difficult-to-staff locations if it aggressively pursued the personnel authorities already available to it, such as

- special pay rates for positions where federal employment is not currently competitive with the private sector and
- obtaining authority to hire personnel directly rather than going through the Office of Personnel Management.

Departmental Oversight Has Benefits

The Congress and the administration should consider the advantages of retaining FAA within the Department, such as integrated transportation planning and the benefits of departmental oversight.

Although some perceive the Department as interfering in FAA's operations, departmental oversight has at least two advantages. First, having aviation—the fastest growing mode of transportation—as part of the Department fosters integrated planning and policy-making among transportation modes. Such integration was intended by the Congress 22 years ago when it placed FAA within the Department, and it is still needed today as the nation addresses the urgent matter of integrating aviation, highway, rail, and mass transit infrastructures to support a national transportation system. We believe it is important to consider whether such integration would encounter greater difficulties if aviation were removed from the

Department. A Department without aviation responsibilities might not be as effective in marshaling and coordinating the resources and political support necessary to meet intermodal challenges.

Second, FAA has benefitted from departmental oversight. As discussed earlier, former Secretary Dole appointed a number of "white glove" task forces, two of which focused on FAA's airline inspection and security screening programs. This oversight was instrumental in FAA's taking a more rigorous and comprehensive approach to aviation security and the air carrier inspection program.

Independent or Not, FAA Will Need Stable Funding

Using the Trust Fund to pay for a greater portion of FAA's costs should be considered.

To effectively manage air traffic control system modernization and work force shortages, FAA must have a source of funding adequate to steadily meet long-term costs. The Airport and Airway Trust Fund was established to provide part of FAA's funding needs. The fund is fed mainly through user fees—for example, an 8-percent tax on each passenger's ticket. A portion of the fund is devoted to capital improvements, such as new radars and air traffic control towers. Within certain limitations set by the Congress, some of the remaining money can be devoted to operations and maintenance activities. The shortfall in operating expenses must be financed from general funds in the U.S. Treasury; that is, FAA has to compete with the myriad of other federal programs that the government funds each year.

While the Trust Fund currently has an unappropriated balance of over $7 billion because of slower-than-expected modernization progress, planned future capital improvement costs dwarf this amount. In addition, future shortfalls will be exacerbated if all operating expenses are paid out by the fund. Indeed, had the Trust Fund receipts been used to finance total FAA outlays for fiscal year 1986, there would have been a deficit of over $1 billion.

A recent President's Aviation Safety Commission report recommended changes in the fund's tax and fee structure, as well as expanded use of the fund to pay a larger share of FAA's costs. Given that the need to fund air traffic control system modernization and work forces will intensify greatly over the next several years, we believe that this funding proposal deserves consideration.

Improving Management of Transportation Infrastructure

Federal, state, and local governments have invested billions of dollars in highways, bridges, mass transit systems, and airports. Despite this huge investment, we reported that considerable portions of the nation's infrastructure are obsolete or deteriorating. Consequently, billions more are needed to repair or replace these assets.

Since both the Highway and Airport and Airway Trust Funds are up for reauthorization in the early 1990s, the timing is right for national attention to be directed at the deterioration and congestion confronting our transportation system. Yet, until needs and their costs are determined accurately and uniformly across modal lines, the Department will be poorly positioned to address transportation infrastructure demands. The Secretary should respond to this challenge by developing an integrated transportation plan that establishes resource priorities.

Needs and Costs Must Be Refined and Prioritized

Transportation must develop an intermodal strategy for responding to infrastructure needs, as well as improve individual needs assessments.

The need to implement an intermodal strategy is not well served by the Department's practice of preparing only separate needs studies for highways, bridges, mass transit, and airways. These transportation modes share common problems, such as their capital investment needs and limited ability to respond effectively to growing congestion. However, the Department's separate modal approach precludes effective intermodal ranking of needs and development of an integrated transportation strategy.

Further, intermodal planning cannot be achieved simply by combining the various studies, as they differ in material respects. For instance, some studies take into account only those needs eligible for federal funds, and others consider all needs. As a result, combining the studies could paint a misleading picture and would be of little help in setting expenditure priorities and exploring low-cost service delivery alternatives.

In addition, individual needs assessments suffer from weaknesses that limit their usefulness.

- The Department estimates that over 240,000 of the nation's 575,000 bridges are deficient and that about $50 billion will be needed to repair or replace them. We found, however, that this estimate is based on inaccurate, incomplete, and inconsistently reported state data. Further, we concluded that in order to provide the Congress a more meaningful basis for program policy and funding decisions, the Department needs to distinguish the varying levels of bridge deficiencies and their costs.

- The Department presents highway needs in total—$315 billion through the year 2000 to maintain 1983 highway conditions. But we found that the Department does not make clear that about one-half of this amount represents backlogged highway needs that already exist.

Future Funding Challenges

Funding mechanisms need to be more responsive to transportation needs.

While the cost of meeting current and future transportation infrastructure needs will be substantial, the nation's ability to respond to these needs is constrained by its current practice of spreading limited federal funds among numerous categorical programs on a modal basis. To effectively respond to transportation needs, it is essential that existing and alternative funding mechanisms be evaluated.

Federal funding mechanisms should be aligned with transportation needs. We found, however, that some of the factors used to apportion federal funds for primary, secondary, and urban highways, such as land area and postal mail route mileage, are not closely related to today's highway needs. To reflect current highway use, these formulas should consider factors such as lane miles of highway, vehicle miles of travel, and motor fuel consumption.

The Congress and the administration should consider funding options to determine how transportation needs can best be met, given resource constraints. One option would be to redefine and streamline federal responsibilities to those considered to be of national and interregional significance, while restructuring the remaining federal programs to give state and local governments more flexibility in using transportation funds. Another option would be to design federal funding mechanisms to encourage increased transportation-user fees at the state and local level, including toll roads and impact fees on developers.

Technological Innovations Could Help

The Department needs to promote technological innovations to extend the life of the existing transportation network and ease the strain of congestion.

Technological innovations show promise for responding to the nation's transportation infrastructure needs. However, an integrated strategic research agenda is needed to close modal research gaps and explore new technological opportunities.

A small improvement in highway performance and durability through innovation could yield savings of billions of dollars. This savings opportunity is being approached through a strategic highway program aimed at improving pavement and bridge materials and components through a program of high-payoff research. Because there is the potential for similar payoffs in other areas, long-term, strategic research programs should be developed for each transportation mode, as well as across modal lines.

There is inconsistent emphasis given to new technological developments across modal lines. For instance, FAA has made a research commitment to commercial use of tilt-rotor aircraft. This aircraft can take off and land vertically—like a helicopter—thus offering possibilities for reducing airport congestion. Another potential alternative for alleviating both airport and highway congestion is magnetic levitation—a new rail technology that goes beyond steel wheel on rail. This is a high-speed intercity rail system capable of speeds in excess of 250 miles an hour. It is under development by Japan and West Germany, but the Federal Railroad Administration's support is limited to funding local feasibility studies.

Certain barriers forestall research and its application, even for less controversial technologies. For instance, we reported that research and development of highway pavement technologies can improve U.S. highways by pointing to opportunities for cost savings and more efficient performance. However, as we found, pavement research and application processes are fragmented, and technology evaluations need improvement.

Reassessing the Coast Guard's Role

The Coast Guard faces expanding responsibilities that threaten to outpace its available resources. It needs to reevaluate the appropriateness of its roles and bring its responsibilities into better alignment with its resources.

Need to Reevaluate Roles and Available Resources

The Coast Guard needs a comprehensive evaluation of its changing roles and responsibilities.

Traditionally, the Coast Guard's primary roles involved water-related safety, including boating safety, search and rescue, and aids to navigation. However, in recent years, the Coast Guard has become increasingly involved in interdicting drug shipments and defense-related activities. To accommodate these new responsibilities, it has significantly shifted its resources. For example, as measured by the share of operating expenses between 1980 and 1987,

- safety missions declined from 60 to 51 percent,
- marine environmental protection declined from almost 13 percent to 7 percent, and
- drug enforcement increased from 7 to 22 percent.

Cutbacks in safety and other areas, announced in early 1988 in response to budget constraints, led to protests from affected parties and legislation directing that service levels be preserved or restored. Aggravating the situation was the Coast Guard's eagerness to take on a new mission—sending a number of cutters to the Persian Gulf—even as it was cutting back random drug patrols and search and rescue operations.

Coast Guard personnel told us that key programs are understaffed, resulting in long work-weeks, and training is inadequate. Further, the capital budget is too small to provide all needed maintenance, parts, and equipment; to replace aging vessels; and to maintain and replace shore facilities.

We believe that the Coast Guard should reconsider the roles it strives to fulfill and the level of performance expected. Among the options that might be considered are

- ranking its major activities and identifying ways to better target safety resources;
- seeking out additional opportunities to delegate or privatize activities and developing sound cost-effectiveness justifications for any such proposals;

- exploring options for greater use of reservists and the Coast Guard auxiliary;
- increasing its emphasis on research and development on labor-saving technologies, such as aids to navigation; and
- identifying opportunities for increased user financing.

Having performed this reevaluation, the Coast Guard would be well positioned to offer options to the Congress on those roles and levels of activity that prudent management and budgetary policy can realistically support.

Better Management Information Is Needed to Support This Reevaluation

The Coast Guard needs current staffing standards and better program effectiveness measures.

A comprehensive reevaluation can yield meaningful results only if it is supported by adequate information. However, we and the Coast Guard itself have noted serious weaknesses in management information. For example, staffing standards help define total resource needs because they determine the number of people needed to effectively perform a particular task. The Coast Guard has not made an overall determination of its staffing needs since 1980.

Program effectiveness measures are also important for making resource allocation decisions, including decisions to curtail or eliminate certain activities and facilities. To improve the overall management of the Department's safety programs and resources, we recommended in 1987 that the Secretary of Transportation develop operational measures of effectiveness for activities like the Coast Guard's recreational boating safety program; two internal Coast Guard studies reached a similar conclusion. However, we recently reported that the Department is still not attempting to measure the program's effectiveness. After reviewing the Coast Guard's rationale for selected facility cutbacks and closings in 1988, we reported a lack of convincing support—including significant weaknesses in savings estimates—and a lack of analysis concerning the effectiveness of facilities slated for closure.

Related GAO Products

Secretarial Leadership	Department of Transportation: Enhancing Policy and Program Effectiveness Through Improved Management (GAO/RCED-87-3, Apr. 13, 1987, and Supplement, GAO/RCED-87-3S, July 24, 1987).
Air Traffic Control Modernization	FAA Staffing: Recruitment, Hiring, and Initial Training of Safety-Related Personnel (GAO/RCED-88-189, Sept. 2, 1988). Microwave Landing Systems: Additional Systems Should Not Be Procured Unless Benefits Proven (GAO/RCED-88-118, May 16, 1988). Testimony on the National Airspace System Plan and Other Federal Aviation Administration Appropriations Issues (GAO/T-RCED-88-35, Apr. 12, 1988). Testimony on the Federal Aviation Administration's Advanced Automation System (GAO/T-IMTEC-88-3, Apr. 12, 1988).
FAA Effectiveness	Testimony on Issues Related to an Independent Federal Aviation Administration (GAO/T-RCED-88-45, June 2, 1988).
Transportation Infrastructure	Highways: How State Agencies Adopt New Pavement Technologies (GAO/PEMD-88-19, Aug. 12, 1988).

Bridge Condition Assessment: Inaccurate Data May Cause Inequities in the Apportionment of Federal-Aid Funds (GAO/RCED-88-75, May 20, 1988).

Highway Needs: An Evaluation of DOT's Process for Assessing the Nation's Highway Needs (GAO/RCED-87-136, Aug. 7, 1987).

Highway Funding: Federal Distribution Formulas Should Be Changed (GAO/RCED-86-114, Mar. 31, 1986).

Coast Guard's Changing Role

Coast Guard: Decision to Phase Out Curtis Bay Yard Is Inadequately Supported (GAO/RCED-89-29, Oct. 7, 1988).

Testimony on Coast Guard Resources, Missions, and Priorities (GAO/T-RCED-88-28, Mar. 22, 1988).

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Transition Series

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

☆U.S. Government Printing Office: 1988-225-357.39418

United States General Accounting Office

GAO

Transition Series

November 1988

Internal Revenue Service Issues

GAO/OCG-89-26TR

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-158195

November 1988

The President of the Senate
The Speaker of the House of Representatives
The Commissioner-designate of Internal Revenue

In this report we summarize several tax administration issues that need closer attention. If these issues are not addressed, the Commissioner can expect (1) serious problems in processing tax returns, (2) a decline in taxpayer confidence in the tax system, and (3) a significant loss in tax revenues that could help reduce the deficit.

IRS needs to modernize its information technology, strengthen human resources, improve collection activities, and narrow the tax gap. As discussed fully in our October 1988 report on overall management at IRS and in other GAO reports and testimonies, IRS has agreed to take steps to resolve many of these issues. A new Commissioner of Internal Revenue will need to direct and encourage those efforts to improve the overall management of the Nation's tax system and collect additional revenues.

Charles A. Bowsher

Charles A. Bowsher

Contents

Letter 1

Modernizing Information Technology 4

Strengthening Human Resources 7

Improving Collection Activities 10

Closing the Tax Gap 13

Related GAO Products 18

Transition Series 20

Modernizing Information Technology

IRS' most pressing overall need is to modernize its outdated and inefficient tax processing system. Returns processing, storage, and retrieval processes are still very much paper-driven and labor-intensive. In March 1988, IRS approved a basic management plan and preliminary designs to improve its computer systems. The implementation of the plan is expected to take about 10 more years to complete and cost several billion dollars. Those estimates could change dramatically, however, because IRS had not, as of August 1988, identified alternative designs, made cost-benefit analyses, and selected a final design.

IRS cannot afford to wait until the mid-1990s for a solution to an impending computer capacity problem. If it does, the processing problems encountered in 1985 in processing tax returns and issuing refunds could reoccur.

- IRS and Congress need to impart the necessary sense of urgency to the redesign effort and ensure that the technical expertise and money are adequate to support the effort.

- A separate Deputy Commissioner with knowledge of, and responsibility for, managing information technology could provide needed direction for this massive endeavor.

IRS accounts for 90 percent of the federal government's revenue—$886.3 billion in fiscal year 1987—and 60 percent of its delinquent receivables. But IRS' ability to satisfy its financial responsibilities has been seriously impeded by long-standing accounting systems problems. These problems are so severe that replacing some of these systems is the only feasible solution. Some systems are often unable to handle the volume of transactions. For example, 13 million payments were processed manually in 1986 because a system could not process all types of tax returns. Indeed, some of the systems are run on equipment that is no longer manufactured, making maintenance a constant problem.

Updating IRS' accounting and financial systems is a multimillion dollar effort. It has a better chance of succeeding if IRS

- designates and supports a chief financial officer position; and

- develops a financial management plan to set priorities, fix accountability, and maintain and monitor financial system operations and improvements.

Strengthening Human Resources

Regardless of systems improvements, unless IRS does a better job of managing its people, it will still not be as effective or efficient as it could be. IRS needs to establish an agencywide human resources plan. It will then be in a better position to provide more central direction and oversight to human resources management throughout the Service.

As IRS automates further, this plan will need to take into account the implications for human resources of an increasingly sophisticated technological environment in which IRS employees will operate. IRS' ability to effectively satisfy its mission will depend to a large extent on its employees' abilities to work effectively in an increasingly automated environment.

Previously, human resource issues were often considered only after an automation project's planning had been completed. That was a mistake. Human resource issues need to be analyzed before a project's conceptual design is approved. That analysis needs to consider the potential effect on the number of employees, the skills, and the training needed to successfully integrate the system into the work place. Then IRS can recruit staff and develop them accordingly.

Presently, many of IRS' recruiting problems stem from its inability to compete with salaries offered by the private sector. In some geographic areas, returns processing staff in the service centers are paid less than employees of local fast food restaurants. IRS faces the same dilemma in trying to recruit revenue agents. It cannot match the salaries offered top accounting graduates by certified public accounting firms and other private employers. Even so, IRS could improve its competitive position through more modern and sophisticated recruiting.

Once staff are hired, quality training is critical to IRS' ability to effectively administer the tax laws. IRS needs to improve its training program.

- A 1987 GAO survey of IRS employees showed that about 57 percent believed their training on tax law changes was less than adequate.
- Our recent work has identified the need to improve the training of employees responsible for answering taxpayer correspondence and telephone inquiries. IRS employees gave incorrect answers 36 percent of the time during the 1988 filing season to people who called for advice.

- We also found that about 50 percent of a sample of letters sent to taxpayers were either incorrect, incomplete, unresponsive, or unclear.

IRS has attempted to improve service quality by emphasizing quality as a priority, implementing a quality assurance plan, hiring seasonal staff earlier in order to provide them more training, and monitoring responses to taxpayers more closely. These efforts are worthwhile and should be continued. IRS should also identify and pay particular attention to recurring service problems to develop ways to resolve them.

Improving Collection Activities

Another area much in need of attention is collecting taxes owed the government.

- As of December 31, 1987, IRS reported a total accounts receivable balance of about $56 billion.
- Although IRS' Internal Audit Division estimates that about $33 billion of the balance is collectible, IRS has little detailed information on the collectibility of the accounts and does not know what collection tools are most effective.
- IRS historically has not paid enough attention to the problem. The result—IRS has been unable to reduce the growth of accounts receivable and collect delinquent taxes, thus depriving the government of a significant source of revenue for reducing the budget deficit. This situation must change.

IRS' accounts receivable figures include duplicate and erroneous delinquencies and amounts that are uncollectible. For example, about $5 billion of the $56 billion inventory are duplicate assessments of employment tax delinquencies. On the other hand, accrued penalties and interest are not included. The amounts of erroneous delinquencies and uncollectible accounts are unknown. IRS has some major initiatives underway to develop more accurate accounts receivable figures. While some improvements are expected in the near future, it may be years before IRS' management information system produces reliable information. An accelerated effort is needed to reliably estimate how much can be collected in the short term.

All too often the immediate response to dealing with the collection problem has been to seek more resources. But, IRS does not know how effective its existing tools are and whether problems exist that need to be addressed. Thus, providing additional resources to collect outstanding delinquencies may not be the best solution. IRS should determine whether existing collection tools, such as periodic notices, levies, and seizures, can deal more effectively with the collection problem.

The most efficient way of dealing with delinquencies is to prevent them from occurring. Unfortunately, IRS' efforts have not been commensurate with the potential benefits. Little has been done to determine why tax delinquencies occur. Without this information, prevention programs will be difficult to develop and neither Congress nor IRS will be in a good position to assist in preventing delinquencies.

The next most efficient way to deal with delinquencies is their early detection. Early detection programs can also bring about improved collection results through reduced delinquencies, particularly for those taxes, such as employment taxes, where additional delinquencies could pyramid quickly before strong collection action is taken. Employers' nonpayment of employment taxes poses significant problems for Congress and IRS. By the time IRS begins collection, the business has, in many situations, such a large delinquency that payment is unlikely. Thus, IRS is faced with seizing the business' assets to collect the outstanding debt and halt future delinquencies. This action can raise socioeconomic issues by causing the business to file for bankruptcy, adding to unemployment.

Closing the Tax Gap

Collecting taxes and penalties already assessed is one problem. An even more intractable one is identifying the correct amount of taxes owed in the first place.

- IRS estimates taxpayers will not pay $87.1 billion in income taxes owed the government for 1988—$64.3 billion in unpaid individual income taxes and $22.8 billion unpaid by corporations.
- This amount could grow to almost $114 billion by 1992.
- There are specific pockets of unpaid taxes that IRS can seek to collect more vigorously.

It is essential that IRS audit more returns each year to improve compliance. The number and percentage of tax returns examined have declined steadily since the late 1970s. IRS examined 42 percent fewer returns in 1987 than in 1978—a decline from 2.3 percent to 1.1 percent of filed returns.

Congress agreed. In fiscal years 1987 and 1988, Congress provided IRS the money to hire 2,500 more examination personnel each year. This was two-thirds of a revenue initiative intended to increase examination coverage from about 1 to almost 2 percent of all returns filed and raise about $10 billion more in revenues between 1987 and 1991. Even so, IRS audited fewer returns in 1987 than the year before because of problems with recruiting revenue agents.

But IRS generated more revenue by concentrating on cases with a higher potential for tax adjustments. While generating more revenues is clearly desirable, especially in an era of budget deficits, it is at the cost of achieving higher levels of coverage across all taxpayer classes. The question is whether more widespread coverage would generate more revenue over the long term by encouraging greater taxpayer compliance. Although reconciling these two competing concerns is difficult, it is necessary.

Other actions can also increase revenues. Each year businesses (sole proprietorships, partnerships, and corporations) earn billions of dollars in third-party income, such as interest and dividends. Corporations reported about $495 billion in interest alone on their 1983 tax returns, while individuals reported $154 billion in interest income for that year. IRS receives millions of business information returns each year for this type of income but does not match them to business tax returns. In contrast, IRS has a well-established information returns matching program for individuals that it uses to identify unreported income that may be subject to tax. In 1987, IRS notified 5 million individuals of potential unreported income problems, which generated $2.8 billion in net additional taxes and penalties. IRS considers this program to be cost effective, with a yield-to-cost ratio of 16 to 1 in 1987.

The idea for a document matching program for businesses has been around since at least 1981. However, IRS has not developed one, even though it estimates that business income, partly subject to information returns reporting, accounts for a large part of the tax gap.

- IRS should develop a business information returns program. With its existing systems, IRS could use information returns to identify business nonfilers and sole proprietors who underreport income.
- IRS should also design an information returns program to cover partnerships and corporations.
- IRS is currently studying the merits of a business information returns program but does not expect to complete the study until

fiscal year 1991. IRS should not wait until 1991 to act.

IRS has major problems identifying and taxing unreported income where no clear paper trail exists, such as informal supplier or "off-the-books" income, and income from illegal sources and unrelated business activities of tax-exempt organizations. IRS officials recognize that they are making few inroads into reducing the informal supplier tax gap, estimated to be $7.7 billion for 1987. We reported that special enforcement program investigations closed in 1982 produced only about $2 million in taxes on illegal income—a tax gap area estimated to be in the billions of dollars. In May 1988 testimony IRS officials also said that fewer than 10 percent of tax-exempt organizations file required tax returns on unrelated business income.

It may be difficult to get at these types of unreported income, but IRS must continue to strive for innovative ways to do so. In our 1986 report on tip income, we discussed one district's innovative computer scoring system designed to identify businesses' unreported tip income and recommended that IRS use this system nationwide. As in the tip income initiative, IRS should encourage its employees to formulate new techniques to detect unreported income in other areas where noncompliance is a significant problem.

The current IRS tax gap does not include estimates for other compliance problems, such as unpaid excise taxes or employment taxes. IRS has not estimated the size of these problems because it does not have the data and methods to do so. Consequently, it is difficult to determine how much additional revenue might be generated by applying additional resources to these areas.

Indications are that significant compliance problems exist in these areas. For example, we reported in 1987 that a large number of independent importers had not paid an estimated $6 million in gas guzzler excise taxes. In addition, IRS believes it has a potentially significant problem involving employers who misclassify workers as independent contractors to avoid employment taxes. IRS should strive to estimate the magnitude of these and other compliance problems. With such estimates, IRS would be in a better position to know how much additional revenue could be collected and begin to design cost-effective strategies for collecting it.

Related GAO Products

Managing IRS: Actions Needed to Assure Quality Service in the Future (GAO/GGD-89-1, Oct. 14, 1988)

Computer Capacity: IRS Must Better Estimate its Computer Resource Needs (GAO/IMTEC-87-5BR, Nov. 4, 1986)

Computer Support for Tax Processing Needs Continuing IRS Attention (GAO/T-IMTEC-87-1, Feb. 6, 1987; GAO/T-IMTEC-88-1, Feb. 23, 1988)

ADP Modernization: IRS' Redesign of Its Tax Administration System (GAO/IMTEC-88-5FS, Nov. 9, 1987)

ADP Modernization: IRS' Tax System Redesign Progress and Plans for the Future (GAO/IMTEC-88-23BR, Apr. 27, 1988)

Tax Administration: IRS' Implementation of the 1987 Revenue Initiative (GAO/GGD-88-16, Dec. 2, 1987)

Tax Administration: Difficulties in Accurately Estimating Tax Examination Yield (GAO/GGD-88-119, Aug. 8, 1988)

IRS' Correspondence With Taxpayers and Its Telephone Assistance Program (GAO/T-GGD-88-47; GAO/GGD-88-101, July 13, 1988)

The 1988 Tax Return Filing Season and IRS' Fiscal Year 1989 Budget (GAO/T-GGD-88-30, Apr. 13, 1988)

Tax Administration: IRS' Tax Gap Studies (GAO/GGD-88-66BR; GAO/T-GGD-88-22, Mar. 31, 1988)

The Merits of Establishing a Business Information Returns Program (GAO/T-GGD-87-4, Mar. 17, 1987)

Tax Administration: IRS' Efforts to Establish a Business Information Returns Program (GAO/GGD-88-102, July 22, 1988)

Tax Administration: Investigating Illegal Income—Success Uncertain, Improvements Needed (GAO/GGD-88-61, Apr. 25, 1988)

Tax Administration: Tip Income Reporting Can Be Increased (GAO/GGD-86-119, Sept. 30, 1986)

Tax Administration: Gas Guzzler Tax Compliance Can Be Increased (GAO/GGD-87-85, July 16, 1987)

Transition Series

The Budget Deficit (GAO/OCG-89-1TR)

The Public Service (GAO/OCG-89-2TR)

Revenue Options (GAO/OCG-89-3TR)

Financial Services Industry Issues (GAO/OCG-89-4TR)

International Trade Issues (GAO/OCG-89-5TR)

Information Technology Issues (GAO/OCG-89-6TR)

Financial Management Issues (GAO/OCG-89-7TR)

Program Evaluation Issues (GAO/OCG-89-8TR)

Defense Issues (GAO/OCG-89-9TR)

Health and Human Services Issues (GAO/OCG-89-10TR)

Commerce Issues (GAO/OCG-89-11TR)

Agriculture Issues (GAO/OCG-89-12TR)

Justice Issues (GAO/OCG-89-13TR)

Veterans Affairs Issues (GAO/OCG-89-14TR)

NASA Issues (GAO/OCG-89-15TR)

Energy Issues (GAO/OCG-89-16TR)

Treasury Issues (GAO/OCG-89-17TR)

Education Issues (GAO/OCG-89-18TR)

Department of State Issues (GAO/OCG-89-19TR)

Environmental Protection Agency Issues (GAO/OCG-89-20TR)

Department of Labor Issues (GAO/OCG-89-21TR)

Housing and Urban Development Issues (GAO/OCG-89-22TR)

Foreign Economic Assistance Issues (GAO/OCG-89-23TR)

Interior Issues (GAO/OCG-89-24TR)

Transportation Issues (GAO/OCG-89-25TR)

Internal Revenue Service Issues (GAO/OCG-89-26TR)

☆U.S. Government Printing Office: 1988-225-357 39418